DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
ASSISTANT SECRETARY
FOR INTERNATIONAL AFFAIRS

MEMORANDUM FOR NORMAN BAILEY
NATIONAL SECURITY COUNCIL

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COUNCIL OF ECONOMIC ADVISORS

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SUBJECT: CCEA WORKING GROUP ON LDC FINANCIAL PROBLEMS

Attached is a revised version of the Background Paper on LDC Debt. Comments received from members of the Working Group have been incorporated in this draft. In addition, a few sections have been updated or edited to make the paper more suitable for transmittal to the CCEA.

Alexis Rieffel
Developing Nations Finance

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BACKGROUND PAPER

ON

LDC DEBT

CCEA Working Group on
LDC Financial Problems

20 January 1982

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EXECUTIVE SUMMARY

I. The Dimensions of LDC Debt *

The total long- and short-term external debt of all 143 LDCs amounted to $489 billion at the end of 1979 (IMF estimate). Four-fifths of the total was long-term debt. The external debt of the non-oil LDCs grew at an average annual rate of 22% during the 1970s in nominal terms -- but only 6-9% after adjusting for inflation.

Debt service payments for the non-oil LDCs grew more rapidly (28% nominal) during the decade, reflecting a shift toward borrowing from private lenders that entailed shorter maturities and higher interest rates. In terms of ratios, the trends were mixed. The ratio of debt outstanding to exports declined from 126% in 1970 to 109% in 1979, and the ratio of foreign-exchange reserves to debt outstanding rose from 29% to 43%, suggesting a lightening of the debt burden. By contrast, the ratio of debt service to exports rose from 16% to 19%.

Perhaps the most important feature of LDC debt is the concentration of debt and debt service among a small group of LDCs which are either oil exporters or major exporters of manufactures. Ten countries account for 50% of the long-term debt of all 143 LDCs. These are Brazil, Mexico, Algeria, India, Indonesia, Korea, Yugoslavia, Argentina, Egypt and Turkey.

The global environment remains unfavorable for countries with emerging debt problems. While the environment may improve somewhat in 1982, there are enough countries with weak balance of payments situations to keep the incidence of debt crises at a relatively high level during the next two to three years.

II. Debt Servicing Difficulties

Three degrees of debt-servicing difficulties can be distinguished: mild, serious and critical. Critical difficulties are indicated by the country's decision to seek debt relief.

An IMF analysis of the causes of debt-servicing difficulties included several notable points: (a) the difficulties evolved over a period of several years; (b) the single most important cause was the adverse impact of fiscal and monetary imbalances on the external sector, especially through rapid import growth; and (c) the imbalances were often related to ambitious development plans or social/political pressures. There is evidence that another important cause was political instability.

* A separate paper on East European debt is being prepared. However, most of the information contained in Part II, IV, and V applies as much to East European (or other) countries as to LDCs.

Since World War II the international community has developed relatively effective ad hoc procedures for assisting countries experiencing debt-servicing difficulties. The IMF plays a central role in these procedures. The procedures followed by official creditors, as embodied in the "Paris Club" are fairly standard. The procedures followed by private creditors (especially commercial banks) are more informal. Typical terms for official debt-relief arrangements are consistently different from those for private arrangements.

The eight most troublesome debt situations at the present time concern Zaire, Sudan, Senegal, Liberia, Bolivia, Jamaica, Costa Rica and Tanzania.

III. U.S. Exposure

U.S. Government exposure in the LDCs at the end of 1980 amounted to $40 billion associated with direct credits and $13 billion with guaranteed credits. AID accounts for almost $15 billion of the direct loans. The other major creditor agencies are Eximbank, DOD, and USDA. USG exposure on direct credits is heaviest in Israel, Egypt, India, Korea, Pakistan, Brazil, and Indonesia. (All over $2 billion.)

Arrearages on all post-WWI USG foreign credits at the end of 1980 were close to $1 billion, but 83% of these were "extraordinary political arrearages" (Cuba, Iran, Vietnam, etc.). LDCs accounted for about two-thirds of the total arrearages. By contrast, collections in CY 1980 were $3.9 billion. However, the arrearage figures do not reflect receipts forgone as a result of debt-relief arrangements. For FY 1981, these shortfalls have been estimated at $412 million (excluding Poland). The budgetary impact of these shortfalls is significant.

The exposure of US banks in non-oil LDCs at the end of 1980 was $111 billion. The nine largest banks accounted for 75% of this exposure. Just four countries (Mexico, Brazil, Korea and Argentina) accounted for 50% of the exposure. Sixty percent of these banks' claims on non-oil LDCs had a remaining maturity of one year or less.

IV. U.S. Policies and Procedures

U.S. policies on extending debt relief to foreign countries spring from the broad responsibilities of the Executive Branch and from the legislation establishing specific foreign credit programs. In a 1970 opinion, the Attorney General concluded that the Executive Branch has considerable flexibility in modifying loan repayment terms, especially when the borrowing country is in a situation of default or imminent default. There is substantial Congressional interest in US debt policy which is reflected in provisions of several authorization and appropriations acts.

Since 1970, the USG has adopted relatively rigorous procedures for identifying and eliminating delinquent payments. There is a formal reporting system that supports these procedures. The principal interagency body concerned with these procedures is the National Advisory Council (NAC) on International Monetary and Financial Policies.

In 1978, the NAC adopted a statement of US policy on debt reorganization. The Treasury Department and the State Department have a joint responsibility for USG participation in debt-relief negotiations --in collaboration with the creditor agencies concerned.

V. Areas of Policy Concern

A. Official Credits

1. On numerous occasions, in recent years, USG agencies have extended loans to countries already unable to meet their existing debt-service obligations to the USG.

2. In certain "prolonged" debt crises (Turkey, Zaire, Sudan and Poland) the traditional approach to debt relief appears to have been inadequate and perhaps hurt efforts to re-establish the countries' creditworthiness.

3. On several occasions in recent years, Eximbank and OPIC have sought and obtained preferred creditor status in debt-rescheduling operations.

4. In 1981, Eximbank, USDA and DOD changed the basis for charging interest on debt relief granted for non-concessional loans. USDA has also proposed charging higher rates on its concessional loans that are rescheduled.

5. In 1981, as an exception to policy, the US extended debt relief to Pakistan when Pakistan was not in a position of imminent default. If repeated, this could lead to increased pressure from LDCs to use debt relief as a form of aid.

6. Non-OECD creditors (e.g., Kuwait, Venezuela and Brazil) have been invited to participate in Paris Club negotiations (when they have been important creditors). Generally they have not participated, and there is some evidence that they have been treated as preferred creditors by the debtor countries.

I. The Dimensions of LDC Debt

There is concern in some quarters that the developing countries as a whole are accumulating too much external debt and that a number of them will have debt servicing problems with serious consequences for commercial bank and government creditors. This section indicates that there is no generalized LDC debt problem, but that uncertainties in the international economic outlook call for careful monitoring of the LDC debt situation. It must be emphasized at the outset that there are serious deficiencies in the existing debt statistics. However, the underlying trends are relatively clear.

A. Trends in LDC Debt and Debt Service

According to a "baseline" IMF study, published in 1981, the total long- and short-term external debt of some 143 LDCs amounted to $489 billion at the end of 1979 (see Table 1).

Table 1

Total External Debt of Developing Countries, End 1979
(In billions of U.S. dollars)

Long-term debt of 143 developing countries and territories as reported by OECD	$391
Short-term debt	85
Use of Fund credit	8
Arrears	5
Total	$489
Breakdown of Long-term Debt	
Public (incl. publicly guaranteed) long-term debt of 87 non-oil LDCs	$239
Private unguaranteed long-term debt of 87 non-oil LDCs	60
Public long-term debt of 7 oil-exporting LDCs	49
Private unguaranteed long-term debt of 7 oil-exporting LDCs	11
Total long-term debt of 49 other LDCs	32
	$391

Source: IMF, External Indebtedness of Developing Countries, Occasional Paper 3, May 1981, page 5. This estimate presumably does not include all outstanding military debt.

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Long-term debt (maturities of over 1 year) comprised almost four-fifths of the grand total. Arrears amounted to slightly more than 1 percent. While such comprehensive data is not available for other years, the trend of LDC debt volume is thought to be reflected accurately enough by the IMF/IBRD's statistics on the long-term debt between 1960 and 1979 of 7 major oil exporting (essentially OPEC) and 87 non-oil LDC borrowers.*

The indebtedness of the non-oil LDCs in nominal terms grew tremendously during the 1970s, at over 20 percent annually (see Table 2), resulting in a four-fold increase between 1972 and 1979.

Table 2

Debt of 87 Non-Oil Developing Countries
(In billions of U.S. dollars)

	1979	Avg. Rate of Change (%) 1972-1979
1. Total long-term Debt outstanding (year end)	$ 299	22
Official creditors	119	17
Private creditors	180	26
2. Debt Service	$ 51	26
Official creditors	10	19
Private creditors	41	28
3. Public Debt Outstanding (end of year)	$ 239	22
a. Disbursements	58	25
b. Amortization	24	27
Net capital flow	34	24
c. Interest payments	13	30
d. Debt Service (b plus c) (Amortization plus Interest)	37	28
Net financial flow (a less d)	21	22

Source: IMF, Occasional Paper 3, p. 7

* The IBRD published a new edition of "World Debt Tables" in December 1981 that contains data on the long-term external debt of 99 LDCs as of the end of 1980. Changes in coverage, definitions and presentation make it difficult to calculate all the 1980 figures that correspond to the 1979 figures included in the IMF paper on which this analysis is based. However, for the 1979 figure of $239 billion for public debt of 87 non-oil LDCs, the corresponding 1980 figure is $282 billion, representing an increase of 18 percent.

More importantly, there was an even larger (fivefold) increase in debt service payments (amortization and interest), reflecting the shortening of average maturites and the rising average interest rates that occured as a result of the rapid growth of private borrowing during the decade (see Table 3).

Table 3

Average Terms of Public Debt Commitments for
94 Developing Countries, 1972-79

	1972	1974	1976	1978	1979	AVG 72-79
Interest Rate						
Official creditors	4.3	4.4	5.5	5.0	5.0	4.8
Private creditors	7.3	9.7	6.8	7.9	11.6	9.0
Average	5.6	7.0	6.8	7.9	9.3	7.1
Maturity						
Official creditors	24.2	23.4	22.1	24.8	25.0	23.9
Private creditors	8.9	10.1	8.1	8.9	8.9	8.9
Average	17.6	16.9	14.3	14.5	14.6	15.7

Source: IMF, Occasional Paper 3, p. 9

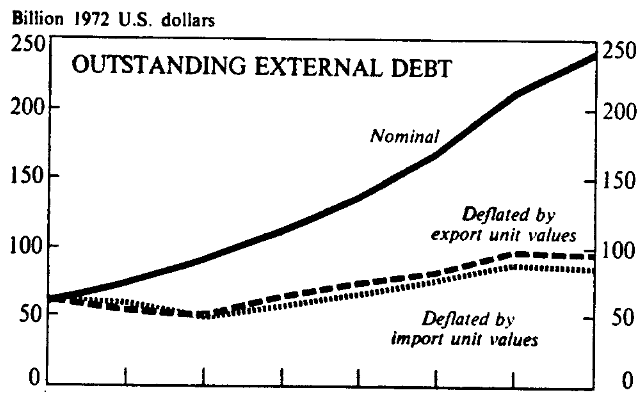
The IMF found that the single most important factor in the rapid growth of total long-term debt was inflation. The IMF analysis indicated that the deflated value of debt increased an average of only 6-9 percent annually during the 1970's, substantially lower than the estimated 12 percent average annual real growth during the 1960s (see Chart 1). With regard to debt service, however, the analysis indicated that the deflated value of debt service increased at about 11 percent annually during both the 1960s and the 1970s.

The IMF also investigated trends in various debt ratios. As shown in Table 4, these ratios deteriorated very badly during the 1960s (1970 vs 1960). During the 1972-74 export boom they

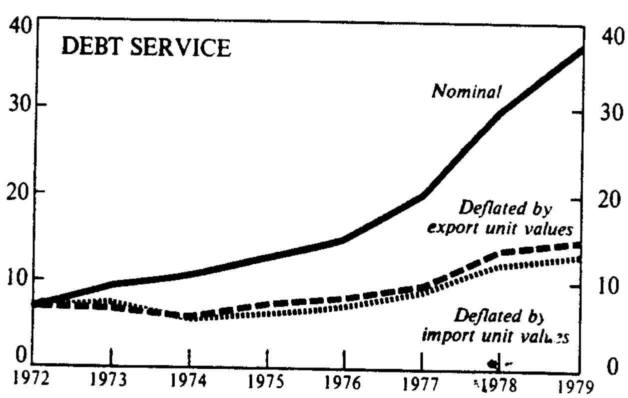
CHART 1 *

Public External Debt and Debt Service for 87 Non-Oil Developing Countries, 1972-79

Debt Outstanding



Debt Service



Source: IMF, Occasional Paper 3, p. 13

improved substantially, but then worsened in the second half of the decade, with the overall result that the ratios of outstanding debt to exports and of reserves to outstanding debt improved during the decade, but the debt service ratio (i.e. the ratio of principal and interest payments to export earnings) rose substantially.

Table 4

Debt to Ratios for 87
Non-oil Developing Countries
1960 and 1970-79
(in percent)

	1960	1970	1972	1974	1976	1978	1979
Debt outstanding/ exports	49	126	111	85	108	116	109
Reserves/debt outstanding	54	29	38	44	32	36	43
Debt service/ exports	7	16	15	13	15	18	19

Source: IMF, Occasional Paper 3, page 6

B. Distribution and Composition of LDC Debt

Perhaps the most important aspect of the LDC debt situation is the concentration of debt and debt service among a small group of 28 LDCs which are either oil exporters or major exporters of manufacturers (See Table 5). Among the 94 LDCs, this group of borrowers accounts for about 70 percent of total debt, about 80 percent of total debt owed to private lenders, and about 75 percent of total debt service. Eleven of the twelve largest borrowers are all members of this group (See Table 6).

In contrast, the group of about 30 low-income non-oil LDCs (including Bangladesh, Pakistan and Zaire) accounts for only about 8 percent of total debt and debt service, and less than 4 percent of debt owed to private lenders.

Table 5

Outstanding Long-term Debt of 94 Developing Countries by Income and Creditor Source, End of 1979
(in billions of U.S. dollars)

	Official Creditors	Private Creditors	Total	Share in Total Debt %
28 exporters of oil or manufactures	$ 81	$ 180	$ 260	72
(Share in group total)	(31)	(69)	100	
36 other net oil importers	31	38	69	19
(Share in group total)	(44)	(56)	100	
30 low-income countries	23	8	30	8
(Share in group total)	(75)	(25)	100	
Total	$ 134	$ 226	$ 359	

Source: IMF, Occasional Paper 3, page 8

Table 6

Outstanding Debt and Debt Service of Developing Countries with Largest Outstanding Debt, 1979 *
(In billion of U.S. dollars)

	Debt Outstanding	Debt Service
Brazil	$ 51.8	$ 10.8
Mexico	33.5	7.8
Algeria	17.2	3.1
India	16.9	1.1
Indonesia	16.0	2.1
Korea	15.8	2.5
Yugoslavia	12.5	2.3
Argentina	12.0	2.4
Egypt	12.0	1.3
Turkey	11.4	1.1
Venezuela	10.8	2.2
Israel	10.0	.9

* List includes all countries with outstanding debt at end-1979 above $10 billion.

Source: IMF, Occasional Paper 3, p. 9

The composition of LDC debt changed markedly during the 1970s. Borrowing from the private sector, particularly from international banks, increased by almost 26 percent annually (see Table 2). This caused the share of debt owed to private lenders to increase from 50 percent in 1973 to 58 percent in 1979-80. Because private-sector loans generally have shorter maturities and higher interest rates than official loans, this resulted in faster growth for debt service payments than for total debt outstanding during the 1970s.

C. The Near-term Outlook

The 1980 IMF study of LDC debt concludes that most debt-servicing difficulties have their origin in inappropriate domestic economic policies. Nevertheless, the global economic environment is also relevant because it can serve to precipitate latent difficulties or to mask them. While there is no simple or direct link between debt crises and oil prices, for example, it is possible to view the rash of rescheduling operations in the 1978-81 period as a fallout of the initial round of oil-price increases in 1973-4 and the second "shock" in 1979-80. In some cases, the debtor country's difficulties stemmed from its inability or unwillingness to adjust domestic policies to changes in the external environment.

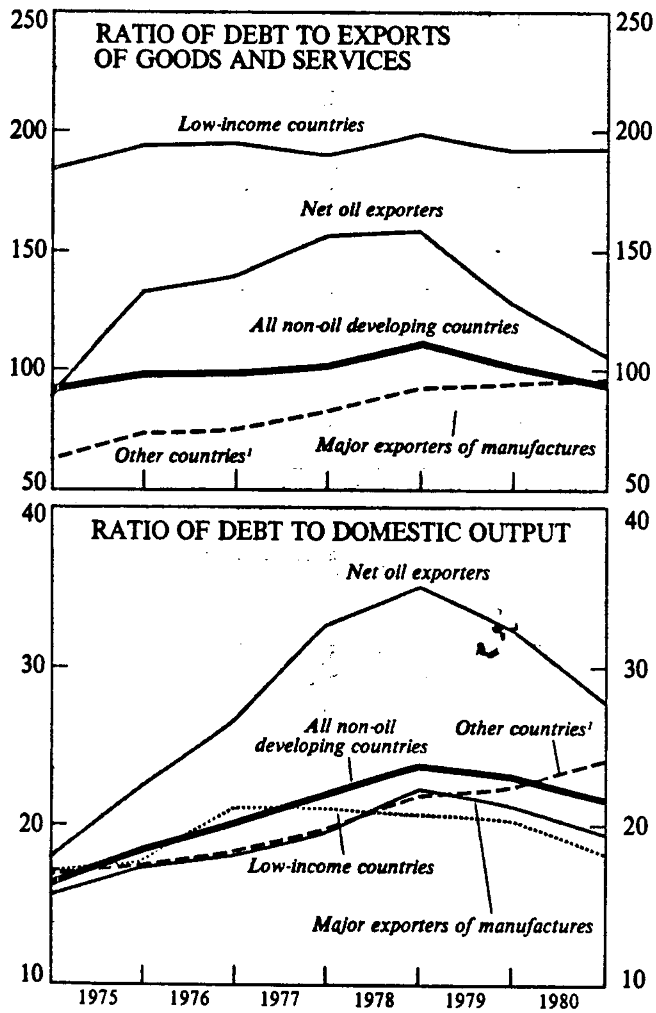
Projections for the near term indicate that it will probably take longer for the non-oil LDCs to adjust to the 1979-80 oil price increases than it took with respect to the 1973-74 oil price increases. In 1980, the non-oil LDCs had a current account deficit, excluding official transfers, of $80 billion, representing a $24 billion increase over 1979. The deficit is expected to rise to above $90 billion in 1981 and to remain at roughly the same that level in 1982. In contrast, the non-oil LDCs' deficit increased substantially in both 1974 and 1975, but declined significantly in 1976 and 1977.

The financing situation for non-oil LDCs worsened dramatically in 1980 and was reminiscent of the situation that existed in 1975. A significant number of countries resorted to accumulation of external payments arrears and/or debt relief from external creditors. For the non-oil LDCs as a group, there was a virtual cessation of reserve accumulation, short-term credits increased sharply as a proportion of their total external borrowing, and the terms of long-term borrowing in international capital markets hardened.

In 1981, the financing situation continued to be difficult. A larger number of countries experienced extreme balance of payments difficulties. For the second year in a row, reserves fell as a percentage of imports for the non-oil LDCs as a group. They were able to finance their large aggregate deficit largely because of stepped-up IMF lending and the readiness of banks to continue to lend substantial amounts. The financing outlook is expected to remain strained in 1982. A major uncertainty in 1982 is the impact of the U.S. recession on world trade.

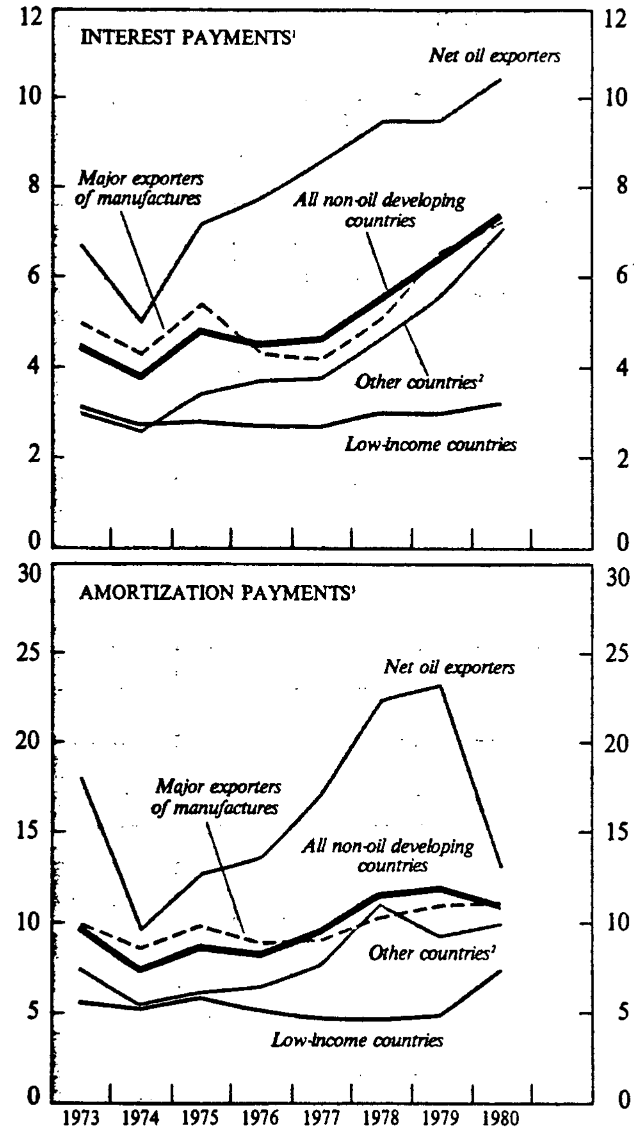
The evolving debt situation for the non-oil LDCs will require careful monitoring because of: (1) the rising trend in the ratio of debt service to exports since the mid-1970s; (2) the poor results from LDC adjustment efforts in 1980-81; and (3) the low ratio of foreign exchange reserves to imports and to debt

Chart 2 Non-Oil Developing Countries: Ratios of Debt to Exports of Goods and Services and to Domestic Output, 1974–80
(In per cent)



[1] Consisting of middle-income countries that, in general, export mainly primary products.

Chart 3 Non-Oil Developing Countries: External Debt Service Payments, 1973–80
(In per cent)



[1] Annual interest payments as percentage of annual exports of goods and services.
[2] Consisting of middle-income countries that, in general, export mainly primary products.
[3] Annual amortization payments as percentage of annual exports of goods and services.

Source: IMF, Annual Report 1981, page 35.

outstanding at the end of 1981. In addition, some oil-exporting LDCs may encounter debt-servicing difficulties if world oil prices remain at their current level or fall.

In general, the global environment remains unfavorable for countries with emerging debt problems. However, commodity prices should begin recovering in 1982 from cyclical lows, there should be relative stability in oil prices, and interest rates on international borrowing should remain below the peaks of 1981. Furthermore, it appears that many countries with weak B/P situations are beginning to implement more effective adjustment policies partly in response to the tougher conditionality associated with IMF arrangements. These considerations suggest that the incidence of new countries experiencing critical difficulties may slack off in the next few years. Nevertheless, there are enough countries with weak B/P situations to keep the incidence of crises at a relatively high level during the next 2-3 years. The most vulnerable countries would appear to include Israel, Egypt, Morocco, Costa Rica, Dominican Republic, Ghana, Zambia, and Tanzania.

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II. Debt-Servicing Difficulties

A. Types of Debt-Servicing Difficulties

Debt-servicing difficulties among the LDCs since 1970 have had different causes and have ranged from minor to severe. The various cases can be crudely divided into three categories in ascending order of their seriousness. Typically, countries with "critical" debt-servicing difficulties have passed through the "mild" and "serious" stages.

1. Mild Difficulties

In these cases, the only symptom of difficulty is an "abnormal" level of arrears. It must be recognized that, for administrative reasons alone, virtually every country has some occasional external payment arrears. These can be considered "normal" if they affect different creditors on a random basis and are cleared up quickly when they are brought to the attention of the borrower. An "abnormal" level of arrears is indicated by the existence of a "queue" for borrowers seeking foreign exchange, or a non-random pattern of arrears to lenders in a particular country or category.

When an "abnormal" level of arrears exists, these are considered as payments restrictions within the meaning of Article VIII of the IMF's Articles of Agreement, and must be reported to the IMF. In the 1981 report of the IMF, Exchange Arrangements and Exchange Restrictions, 26 countries were identified as having arrears (within the meaning of Article VIII) at the end of 1980. Of these, five countries were experiencing mild debt difficulties and the others more serious difficulties. (See Table 7)

Table 7

Countries with Article VIII Arrears

at the End of 1980, by Category

1. Mild Debt-Servicing Difficulties (5)

   Chad
   Congo, P.R.
   The Gambia
   Guinea
   Guinea-Bissau

2. Serious Debt-Servicing Difficulties (8)

   Costa Rica
   Dominican Republic
   Ghana
   Guyana
   Mauritius
   Somalia
   Tanzania
   Zambia

3. Critical Debt-Servicing Difficulties (11)*

   Bolivia (P)
   Central African Republic (O)
   Jamaica (P)
   Madagascar (O)
   Nicaragua (P + O)
   Senegal (P + O)
   Sierra Leone (O)
   Sudan (P + O)
   Togo (P + O)
   Uganda (O)
   Zaire (P + O)

* P = Debt relief from private creditors in 1980-81
  O = Debt relief from official creditors in 1980-81

Treasury/IDN
5 November 1981

Generally, a country experiencing "mild" difficulties is able to overcome these difficulties without policy changes or with relatively small changes. Moreover, such a country does not usually seek an upper credit tranche arrangement with the IMF.

2. Serious Difficulties

The essential difference between mild and serious difficulties lies in the measures necessary to overcome the difficulties. Generally, a country experiencing serious difficulties has a deteriorating balance of payments situation. Its current account deficit has reached an unsustainable level, or trends are clearly moving the external accounts in that direction. Private lenders become reluctant to provide new financing, and capital flight may be evident. In these circumstances, it is necessary for the country to undertake substantial economic policy reforms either to reverse trends or to reduce the deficit.

Symptoms of serious difficulties include long queues for foreign exchange, rising spreads on borrowing in international capital markets, drawdown of foreign exchange reserves, increased recourse to short-term lending, and efforts to obtain extraordinary B/P financing from official creditors. Countries with serious payment difficulties usually seek an upper credit tranche arrangement with the IMF.

Eight countries with Article VIII arrears at the end of 1980 fell in this category. (Table 7.)

3. Critical Difficulties

The essential difference between serious and critical difficulties is the debtor country's decision to seek debt relief. Generally, countries with critical difficulties are unable to meet payment obligations to external creditors even after implementing major economic reforms. In some cases, debt relief from private creditors only is sought. In others, debt relief from official creditors only is sought. In most cases, however, relief is sought from both private and official creditors.

In virtually every case where debt relief is obtained, the creditors condition their relief on the conclusion of an upper credit tranche arrangement with the IMF. Eleven countries with Article VIII arrears at the end of 1980 fell in this category. (Table 7.)

B. Causes of Debt-Servicing Difficulties

It is hard to improve on the analysis of causes of debt-servicing difficulties provided by the IMF staff a year ago. (SM/80/274, 30 December 1980). This analysis was based on the experience of eleven countries that sought and received debt relief through multilateral negotiations with official creditors during the period 1975-1980.* The Fund staff's description of this analysis is contained in Appendix A. The main points of the analysis are the following:

-- Debt-servicing difficulties evolved over a period of several years and could not be explained by developments immediately preceding the debt-relief negotiations.

-- The single most important cause of payments difficulty was the impact of fiscal and monetary imbalances on the external sector.

-- These imbalances created demand pressure that was reflected in rapid import growth. The sharp increase in world oil

* Chile, India, Zaire, Sierra Leone, Turkey, Gabon, Peru, Togo, Sudan, Pakistan and Liberia.

prices was also a major determinent of higher imports.

-- The demand pressures nearly always could be attributed to domestic factors and particularly to expansionary budgetary and financial policies. Budgetary imbalances were often related to ambitious development plans or social and political pressure.

-- In most cases, the difficulties were exacerbated by declining, stagnating, or strongly fluctuating exports.

-- Typically, the countries attempted to finance current account deficits through external credits with short maturities and commercial interest rates.

-- Inappropriate debt management was a primary cause in some cases.

-- Sharp declines or outflows of private capital were a major factor in some cases.

Presumably, for "diplomatic" reasons, the Fund paper glosses over political instability as a cause of debt-servicing difficulties. In at least five of the eleven cases studied by the IMF, the governments in power believed that they did not have a sufficient margin of power to implement economic stabilization measures in the face of their domestic opposition.

C. Procedures for Assisting Countries in Difficulty

Since World War II, the international community has developed fairly simple and mostly ad hoc, procedures for assisting countries experiencing debt-servicing difficulties. The central role is played by the IMF -- which is involved at every level of difficulty.

In the case of countries with mild difficulties, the IMF provides an indirect "early warning system" through its annual reports on Exchange Arrangements and Exchange Restrictions. More importantly, in its annual Article IV consultations with member countries, the IMF staff has a responsibility to alert the member to an emerging debt problem and to suggest procedures for avoiding the problem.

For countries experiencing serious difficulties, the IMF assists them in formulating an economic program that will correct the underlying imbalances, and provides temporary balance of payments (B/P) financing that allows them to avoid a sharp contraction in economic activity while their program is taking hold.

For countries with critical difficulties, foreign creditors as well as the debtor country rely heavily on the Fund. The debtor country relies on the Fund for the normal B/P financing and advice. In addition, it can obtain assistance from the Fund staff in preparing for negotiations with its foreign creditors. The foreign creditors rely on the Fund to ensure that the debt relief they provide is not "wasted". This is accomplished by insisting on an upper credit tranche arrangement with the IMF as a condition for negotiating a debt relief arrangement, which entails having the IMF staff monitor performance while the debtor country is benefitting from debt relief.

The IBRD plays an important but more limited role. For many years, the World Bank has required that its borrowers provide to the Bank detailed information on their external indebtedness. The "Debtor Reporting System" which has evolved is the starting point for most analytical work done on LDC debt, both for individual countries and groups of countries. In addition, the IBRD has assisted countries in establishing or improving debt management systems.

In crisis situations, when debt relief is necessary to avoid default, parallel procedures have evolved for arranging debt relief from official creditors on the one hand and private creditors on the other. Each are described briefly below.

1. Debt Relief from Official Creditors

There are no treaties governing international debt-relief operations, nor are there any formal "rules" that have been adopted by creditor countries for multilateral "creditor club" negotiations. The current approach has evolved from a multilateral operation in 1956 involving Argentina -- in effect a "common law" approach to this form of financial assistance. However, in September 1980, the Trade and Development Board (TDB) of the United Nations Conference on Trade and Development (UNCTAD) adopted a resolution on "Debt and Development Problems of Developing Countries" that provides some formal recognition of the current approach, while also giving some recognition of possible alternative approaches. This resolution is contained in Appendix B.

The procedures that are generally followed at the present time (as embodied in the "Paris Club") include the elements listed below.*

1. Consideration of debt relief must be initiated by the debtor country. (Normally this is accomplished by a letter addressed to the French Treasury requesting a meeting with major creditor countries.)

2. Debt relief is only granted to countries in a situation of default or imminent default.

3. Prior to negotiations, the debtor country must undertake an economic program designed to re-establish its creditworthiness. (A program supported by an upper credit tranche arrangement with the IMF typically allows debtor and creditor countries to avoid direct negotiations over the content of an acceptable program.)

4. The debts subject to negotiation are those arising from credits extended, guaranteed or insured by the creditor-country governments. (Unguaranteed credits from commercial banks and other private lenders are dealt with separately. Credits from the IBRD and other multilateral institutions are exempt from rescheduling by tradition.)

5. The debtor country must agree to provide most-favored-nation treatment tc governments providing debt relief. (This means that COMECON or LDC creditors end up giving debt relief on the same terms as the western creditors agree to.)

6. The debtor country must seek to obtain "comparable treatment" from other categories of creditors, e.g. commercial banks.

* While the majority of debt reschedulings have been negotiated in the "Paris Club" forum, there have been exceptions, notably negotiations in the OECD Consortium for Turkey and IBRD Consortia for Pakistan and India. In the cases of India (1968-72) and Pakistan (1981) debt relief was granted as a substitute for aid since these countries were not encountering debt-servicing difficulties. In the case of Pakistan (1981), a presidential decision was made to extend debt relief to Pakistan as an exception to U.S. policy. There were also unusual aspects of the 1981 del [illegible] Poland

(This is usually accomplished in parallel arrangements negotiated with a bank steering committee sometimes referred to as the "London Club".)

7. The multilateral debt relief arrangement that is negotiated is *ad referendum* in nature, and must be implemented by separate bilateral agreements with each creditor country. (In the case of the U.S., the bilateral agreement is followed by separate agreements with each creditor agency.)

It should be stressed that the *ad hoc* nature of these negotiations is especially significant to the U.S. and most other creditor countries. In various international negotiations since 1976 (mostly in the North/South context), the U.S. has successfully defended the principle of a case-by-case approach to debt relief. These efforts have included resistance to any institutionalization of the "Paris Club". The U.S., in principle, is prepared to participate in negotiations chaired by any creditor country in any location, and we have been adamantly opposed to the establishment of an international secretariat for the "Paris Club". The rationale underlying this position is that the existence of a permanent institution responsible for debt-relief operations will encourage debtor countries to seek debt relief as a normal form of financial assistance. The debt relief process must remain unattractive (by being somewhat unpredictable and painful) in order to maintain discipline in the financial system and preserve respect for financial contracts.

The Government of France has a standing offer to host debt-relief negotiations in Paris with the understanding that it would chair these negotiations. The French Government bears all the administrative costs associated with the negotiations (conference facilities, translating services, compilation and distribution of data, and preparation of documents), and in return achieves some influence over the negotiating process. The current "Chairman" of the Paris Club is Michel Camdessus, Director of the French Treasury (a rank equivalent to the U.S. Treasury Department's Assistant Secretary for International Affairs). Mr. Camdessus has been a polished and effective chairman, although there have been occasions when he appeared to use his position to produce an outcome biased toward French interests. In international negotiations relating to procedures for debt-relief operations, the French have also appeared willing to compromise creditor-country objectives in order to obtain developing-country acceptance of the "Paris Club" as a legitimate international financial institution.

2. Debt Relief from Private Creditors

Debt-relief arrangements with private creditors have taken many forms including formal rescheduling arrangements, programs for eliminating arrears, compensation in the form of term deposits, and settlements in local currency. The only form of arrangement that was studied by the IMF staff in its baseline report last year was the "London Club" arrangement involving commercial banks -- which is also the financially most significant form of arrangement.

For most LDCs, there are generally many foreign banks that have extended loans, with head offices in a number of different countries. When the borrower fails to make payments in a timely manner, the banks form a "steering committee", usually consisting of the one or two banks with the heaviest exposure from each country. When the steering committee has reached agreement in principle with the debtor country, all the banks must approve of the agreement before it goes into effect. Because of the large number of banks involved these negotiations can become quite protracted.

In the typical case, the bank debt being rescheduled is long-term debt. However, in some cases, e.g. Turkey (1979), short-term lines of credit and deposits also have been included.

D. Terms of Debt Relief

1. Official Creditors

The terms of debt-relief arrangements with official creditors are arrived at in an *ad hoc* manner, but with close attention to precedents. Conceptually, creditor countries have resisted the notion that the terms of relief must be set to close a particular financial gap -- because this would imply an obligation on the part of creditors to help the debtor country achieve a pre-determined level of economic activity (growth rate). Instead, debt relief is viewed as one of several distinct forms of extraordinary financing available to fill an external resource gap (others include IMF credit, bilateral balance-of-payment loans, and short-term financing from commercial banks). Also, the size of this gap is not a given but depends on internal policies adopted by the country and on external factors (like commodity prices) over which it has no control. The terms of debt relief, then, are set as hard as possible consistent with the country's efforts to re-establish its creditworthiness. However, some consideration is given to the level of development of the debtor country. A relatively poor and less developed country may be offered more generous terms than a relatively wealthy and advanced country with a similar debt problem.

It is also essential to understand that each debt-relief arrangement involves a package of terms. Because there are financial trade-offs among terms, it is possible to construct two packages that are financially equivalent (in terms of their present value), but appear very different. For example, one package may include a higher percentage of payments rescheduled, but the repayment period would be shorter. The maximum terms granted in recent reschedulings for each of the major variables are described below. Any package including more generous terms for any of these variables would represent a precedent that creditors could have difficulty avoiding in future operations.

a. Consolidation Period: one-plus-one-plus-one (Turkey, 1980)

In the typical official operation, the debt relief granted is limited to payments falling due in a specific period (the consolidation period). Official creditors prefer to limit the consolidation period to one year. However, in recent years, creditors have agreed to provide a second (or third) year of relief on the same terms on the condition that the debtor country remains eligible to draw under an appropriate standby arrangement with the IMF.

b. Payments Covered: principal plus interest (Liberia, 1980; etc.)

Creditors prefer to reschedule principal payments only (as is the custom with commercial banks). However, the 1978 Peru operation was the only official operation in recent years that did not also include interest payments.

c. Percent of Payments Consolidated: 90 percent (Zaire, 1979; Turkey, 1980)

The lowest percentage of payments consolidated in recent years was 70 percent (Chile, 1975).

d. Grace Period: 5 years (Sierra Leone, 1980)
Repayment Period: 11 years -- including grace (Sierra Leone, 1980)

The shortest grace and repayment periods offered in recent years were 3 and 7 1/2 respectively (Peru, 1978).

e. Non-Consolidated Debt: repaid over the grace period of 5 years (Turkey, 1980)

At the least generous extreme, non-consolidated debt is paid according to the original contracts. It should be understood that stretching out non-consolidated debt over the grace period is financially equivalent to rescheduling 100 percent of the debt falling due during the consolidation period.

f. Interest Rate: negotiated bilaterally

Debtor countries have invariably requested concessional interest rates on the amounts rescheduled. Creditors have been adamantly opposed to this for two reasons: (a) interest rate structures vary tremendously among creditor countries, so that any given rate would represent a concessional rate for some and an excessive rate for others; and (b) implementation would be complicated because credits from different agencies of the same creditor country carry widely different interest rates. Therefore, the general practice is to charge interest on the rescheduled amounts on the same basis as the original contracts. For example, when AID and PL480 loans are rescheduled, the U.S. charges 2-4 percent on the amounts rescheduled. Until recently, when Eximbank, CCC or military credits were rescheduled, the U.S. charged the current lending rate for new loans of equivalent maturity. (This could be a higher or lower rate compared to the weighted average rate of the original contracts.) In mid-1981, largely under the influence of the Poland debt-relief arrangement, Eximbank switched to a policy of charging its current borrowing rate on rescheduling credits instead of its (subsidized) lending rate. This had the effect of moving the rate from the 9-10 percent range to the 13-15 percent range. At the same time, it decided to make the rate variable at six month intervals. Similar actions have been taken by USDA and DOD in rescheduling their non-concessional credits.

2. Private Creditors

In some arrangements, commercial banks have rescheduled amortization payments falling due within a specified period -- usually not more than a year. In other arrangements, banks have reorganized the entire stock of outstanding debt owed by the debtor country. This second practice makes sense when the maturity structure of the stock is heavily skewed toward the near term. With two exceptions, the debt relief offered by banks has been limited to principal, and the debtor country has been expected to remain current on all interest due. The first exception is Nicaragua where the banks agreed (in 1980) to capitalize interest due above a 7 percent "cap". The second exception is Sudan where the banks agreed (in 1981) to capitalize roughly $100 million out of about $200 million in overdue interest payments.

Rescheduled bank debt has been repayable in a maximum of ten years including five years of grace (Zaire, 1979). However, the repayment terms in the case of Turkey were later renegotiated to extend the repayment period to twelve years. With respect to interest charged on rescheduled bank debt, the banks have generally charged a high spread over LIBOR that is sometimes greater than the spread on the original loans.

E. The "Crisis" Countries

Capsule descriptions of the most troublesome debt situations are provided below, beginning with the most intractable cases. Descriptions of the situations in Costa Rica and Tanzania are also provided, even though they have not yet reached the crisis stage, because they are rapidly approaching this stage. (Poland and Turkey are omitted because they are not LDCs.)

1. Zaire

Economic mismanagement is at the root of Zaire's difficulties. Debt relief has been provided by official creditors every year since 1976. A two-year ("one-plus-one") agreement was negotiated last July which will probably have to be renegotiated before the end of 1982. Commercial banks rescheduled most of their exposure in Zaire in 1979.

2. Sudan.

The Sudan mounted an over-ambitious development program in the mid-1970's based on expected massive external aid flows which failed to materialize. A two-year debt relief arrangement with official creditors negotiated in 1979 has expired, and a new one will be negotiated as soon as Sudan concludes a new standby arrangement with the IMF -- tentatively scheduled for the first week in February, 1982. Official creditors will probably be asked to reschedule previously-rescheduled debt. Sudan signed a debt relief arrangement with commercial banks on December 30, 1981, which will go into effect at the end of March, 1982, if Sudan's arrangement with the IMF has been approved and the GOS is able to make a down-payment of about $106 million.

3. Senegal

Drought in two successive years had a disastrous impact on Senegal's export earnings from groundnuts. Debt-relief extended by official creditors in October 1981 should enable Senegal to get back on its feet assuming good weather and bountiful harvests in the years ahead. Debt-relief negotiations are in progress between the GOS and its commercial bank creditors.

4. Liberia

Liberia has been experiencing severe cash flow problems since a coup in April 1980 -- complicated by the fact that the currency of Liberia is the U.S. dollar. Financial collapse has barely been averted by substantial budgetary support from the U.S., IMF credit, and debt relief from official creditors, beginning in mid-1980 and extending through mid-1983. Negotiations with commercial banks for debt relief have recently begun.

5. Bolivia

Chronic mismanagement of the state enterprises along with expansionary budget policies and inadequate revenue mechanisms are largely responsible for Bolivia's external debt crisis. The military government which assumed power in July 1980 has compounded the economic and financial difficulties. Interim agreement was reached in April 1981 on a renegotiation of debt with commercial creditors. A third 90-day waiver was granted on the $460 million of rescheduled external commercial debt on January 15, 1982, despite the lack of a Fund program. It is unclear when agreement on a Fund program will be concluded.

6. Jamaica

More than half a decade of heavy reliance on foreign financial resources has left Jamaica with a sizeable foreign public debt which stood at $1.2 billion at the end of 1980. The debt service ratio in 1980 was 18 percent before refinancing operations and was reduced to 12 percent after a commercial debt rescheduling. A three-year $580 million EFF was approved in April 1981. The GOJ has occasionally mentioned the possibility of seeking debt relief from official creditors, but its debt-service obligations to those creditors are relatively small.

7. Costa Rica.

Persistent economic mismanagement, primarily overly expansionary fiscal policies and inappropriate exchange rate policies, has lead to an unsustainable balance of payments situation. The government of Costa Rica is currently over $125 million in arrears to private creditors. The GOCR was out of compliance with its three-year $330 million EFF, approved in June 1981, after the first quarterly period. Negotiations which began in November on a new standby program have been progressing slowly. It seems likely that there will be no new IMF program until the Spring.

8. Tanzania

In relative terms, Tanzania has by far the worst arrearage situation in the world. Restructuring of its debt has been delayed by the government's inability or unwillingness to adopt the economic reforms necessary to qualify for B/P support from the IMF.

III. U.S. Exposure

A. Government

1. Level and Composition

U.S. Government exposure in the LDCs at the end of 1980 amounted to approximately $39.6 billion in outstanding principal indebtedness from post-World War II USG credits plus $13.1 billion of USG contingent liabilities from its foreign insurance and guarantee programs (see Table 8). $1.5 billion was owed by private-sector obligors and the balance by foreign governments. Virtually all of the indebtedness from credits, or $39.0 billion, was owed on account of long-term credits (those with maturities of more than 1 year). Of the remainder, $180 million resulted from short-term credits (maturities of 90 days to 1 year) and $414 million from accounts receivable (maturities of less than 90 days).

Most of the long-term foreign debt owed to the U.S. Government pertains to development assistance, military aid, and export credit programs undertaken during the past 30 years. Almost $15 billion of the indebtedness was contracted for under the Foreign Assistance Act (and predecessor legislation); about $7.5 billion under Public Law 480 programs; about $7.6 billion under the Arms Export Control Act; $8.4 billion under the Export-Import Bank Act; and $0.5 billion under the the Commodity Credit Corporation Charter Act.

With regard to the long-term debt, the largest country debtors to the U.S. Government in the developing country category were: Israel ($6.4 billion); Egypt ($3.7 billion); India ($3.3 billion); Korea (3.0 billion); Pakistan ($2.6 billion); Brazil ($2.3 billion); Indonesia ($2.2 billion); Taiwan ($1.5 billion); and Mexico ($0.9 billion).

Table 8

U.S. Government Exposure in LDCs
on Direct Long-term Credits
and Guarantee Programs
as of 31 December 1980
($ millions)

	Outstanding Long-term Principal Indebtedness on USG Foreign Credits	USG Contingent Liabilities on Foreign Insurance and Guarantees
Export Import Bank	$ 8,450	$ 6,956
AID Foreign Assistance and Related Acts (incl. OPIC)	14,797	5,085
DOD Foreign Military Sales	7,574	334
USDA	8,057	649
PL-480 Dollar Loans	6,847	0
PL-480 Foreign Currency Loans	662 *	0
CCC Export Credits and Guarantees	548	649
TREASURY Lend-Lease, Surplus Property and Other War Accounts	77	0
Other Credits	7	0
TOTAL	$ 38,962	$ 13,024

* not repayable in US Dollars

Treasury/IDN
19 November 1981

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The $13 billion of USG contingent liabilities on its foreign insurance and guarantees of private credits at the end of 1980 were largely under Export Import Bank programs ($7 billion) and OPIC investments support programs ($5 billion). (OPIC insurance on equity investments in LDCs are not included.) The major LDCs involved were: Korea ($1.6 billion), Israel ($1.1 billion), Mexico ($1.0 billion), Brazil ($.7 billion), Taiwan ($.7 billion), Philippines ($.6 billion, Venezuela ($.6 billion) and Argentina ($.5 billion.)

Total arrearages on all post World War I debt owed to the U. S. Government amounted to about $1 billion at the end of 1980.* (Table 9 classifies arrearages by the type of collection problem encountered.) Almost two-thirds of these arrearages were owed by the LDCs; about $522 million were delinquent principal and interest payments on long-term credits, and another $119 million were delinquent payments on short-term credits and accounts receivable. While these arrearages constitute a very minor portion of total foreign debt service payments owed to, and being collected by USG agencies, they understate the loss of receipts to the US by omitting certain debt-service payments that have been rescheduled.

2. Estimates of Short-falls and Budget Impact

Table 10 lists estimated shortfalls in scheduled receipts during FY 1981 in connection with debt-rescheduling operations or arrears. The shortfalls totaled $412 million, dominated by the amount for Turkey ($280 million).

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* In calendar year 1980, the United States collected from the LDCs estimated repayments of about $3.9 billion of principal and interest due on long-term credits.

Table 9

ARREARAGES OF 90 OR MORE DAYS ON FOREIGN LOANS AND CREDITS OF U.S. GOVERNMENT AGENCIES*

	(In $ Millions) Dec. 31, 1980	Sept. 30, 1980
I. EXTRAORDINARY POLITICAL ARREARAGES		
A. Long-Term, of which:		
1. China (Unspecified) 1/	91.2	91.1
2. Cuba	77.8	77.2
3. Czechoslovakia	8.2	8.2
4. Iran	382.0	330.3
5. Kampuchea	24.0	21.7
6. Viet Nam, Republic of	19.2	19.2
B. Short-Term and Accounts Receivable, of which:		
1. China (Unspecified) 1/	20.2	20.2
2. Cuba	3.0	3.0
3. Iran	2.3	1.9
4. Kampuchea and Viet Nam, Republic of	.2	.2
5. Unresolved Korean War Logistical Support	199.7	199.7
TOTAL POLITICAL	829.2	772.7
(Percent of Overall Total)	(83%)	(81%)
II. MAJOR ARREARAGES - Public long-term, of which:		
1. Turkey 2/	25.9	23.4
2. Zaire 3/	34.3	27.3
TOTAL MAJOR ARREARAGES	60.2	50.7
(Percent of Overall Total)	(6%)	(5%)
III. OTHER ARREARAGES		
A. Public,		
1. Long-Term	46.7	42.7
2. Short-Term and Accounts Receivable, of which:	44.3	65.6
Financing Military Sales, Logistical Support, M.A.A.G.	16.8	14.5
Postal Service	16.9	21.9
Other	10.6	29.2
B. Private		
1. Long-Term	17.0	18.3
2. Short-Term and Accounts Receivable	2.9	1.6
TOTAL OTHER ARREARAGES	110.9	128.2
	(11%)	(14%)
OVERALL TOTAL - Groups I, II, and III	1,001.0	951.5
	(100%)	(100%)

* Notes: Excludes World War I debt. Items may not add to totals due to rounding.

1/ Refers to obligations incurred by China prior to 1949 whose status is currently under review. Does not include $50.1 million of principal and assets left on the Asian continent which were financed by Export-Import Bank and on which Export-Import has deferred action.

2/ Includes amounts due AID, PL-480, Treasury and EXIMBANK under a bilateral rescheduling agreement signed October 24, 1980. Once implementing agreements have been concluded these amounts will no longer be reported as being in arrears.

3/ Includes amounts due on AID programs and to other U.S.G. agencies under a bilateral rescheduling agreement signed on July 28, 1980 between the U.S.G. and Zaire. Once implementing agreements have been concluded by the agencies concerned, these amounts will no longer be reported as being in arrears.

Source: U.S. Treasury Department, March 30, 1981

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TABLE 10

DEBT RELIEF ANTICIPATED

and SHORTFALLS IN RECEIPTS

in FY 1981*

($ million)

A. Rescheduling Cases	
Turkey	$280
Zaire	65
Pakistan	53
Liberia	4
Sudan	4
Uganda	3
Senegal	2
Togo	1
Central African Republic	0.5
	$412.5
B. Arrearage Cases	
Iran	$75
Khmer Republic	4
Vietnam	3
Nicaragua	2
	$84
Total (A & B)	$496.5

* Includes claims paid on guaranteed credits. Amounts are gross amounts falling due during FY 1981 that were rescheduled. Rescheduled arrears and interest received on rescheduled amounts are not shown.

(This list omits Poland which was scheduled to pay USG agencies about $527 million in FY 1981.)

Scheduled payments of interest and principal from LDCs to USG creditor agencies on direct credits during FY 1982 amount to about $6 billion. In Table 11 we have divided all countries with scheduled payments to the USG into three categories based on the likelihood of interruption in payments to the US. For the first two categories, estimated FY 1982 repayments to private lenders guaranteed by U.S. agencies (i.e. contingent liabilities) are also shown.

Table 11

U.S. GOVERNMENT EXPOSURE IN LDCs ON ITS DIRECT CREDIT AND GUARANTEE PROGRAMS - By Country and Risk Category

($ millions)

	Outstanding Long-term Principal Indebtedness on USG Foreign Credits (12/31/80)	FY 1982 Debt Service on Direct Credits	USG Contingent Liabilities, on Foreign Insurance and Guarantees (12/31/80)	FY 1982 Debt Service on Contingent Liabilities
Category A: Countries with debt relief arrangements concluded or under negotiation.				
Zaire	660	58	202	48
Iran	400	52	97	9
Bolivia	335	23	34	5
Nicaragua	190	12	32	3
Jamaica	137	22	407	39
Liberia	110	6	29	4
Costa Rica	104	10	107	21
Sudan	102	7	101	18
Guinea	94	6	156	14
Sierra Leone	29	2	69	6
Senegal	21	5	11	2
Uganda	12	1	1	0
Madagascar	6	0	25	7
Central African Rep.	3	1	*	0
Togo	2	0	4	1
TOTALS (15 countries)	2,205	205	1,275	175

(Table 11 continuation)

Category B: Countries with "weak" B/P situations and indebtedness above $50 million.

Israel	6382	829	1050	361
Egypt	3748	300	275	52
India	3340	171	152	12
Pakistan	2650	115	46	4
Brazil	2297	297	726	170
Mexico	922	121	1012	274
Bangladesh	840	19	6	0
Chile	729	76	277	22
Philippines	720	52	637	169
Morocco	616	80	39	9
Peru	463	65	273	109
Thailand	418	48	177	83
Jordan	404	128	22	4
Dominican Republic	330	18	378	61
Sri Lanka	285	10	14	5
Khmer Republic	209	0	0	0
Ghana	205	21	99	8
Syria	192	10	5	0
Panama	190	17	203	25
Zambia	172	11	105	19
Kenya	151	18	84	10
Honduras	135	10	101	21
Guatemala	130	8	79	12
Ethiopia	130	7	2	3
Afghanistan	128	4	*	0
El Salvador	108	6	52	4
Tanzania	104	3	10	1
Vietnam	100	2	13	0
Lebanon	95	29	15	1
Ivory Coast	86	24	94	17
Haiti	78	4	13	1
Uruguay	77	7	20	6
Guyana	70	5	36	9
Total (33 countries)	26,504	2,515	6,015	1,472

(Table 11 continuation)

Category C: Countries with "strong" balance of payments positions' and indebtedness to the USG above $50 million.

Korea	2997	1644
Indonesia	2240	351
Taiwan	1522	651
Colombia	866	158
Algeria	701	267
Tunisia	418	47
Argentina	292	536
Singapore	245	39
Venezuela	182	576
Ecuador	151	210
Trinidad and Tobago	132	176
Nigeria	79	77
Malaysia	65	92
Cameroon	62	27
Paraguay	55	22
Hong Kong	40	16
Total (16 countries)	10,047	4,889

Category D: Countries with USG obligations below $50 million as of December 31, 1980

(34 countries)	206	845
TOTAL A, B, C, D (98 non-OPEC & non-OECD countries)	38,962	13,024

* less than $500,000

Treasury/IDN
2 December 1981

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B. Private Lenders

1. General

This section describes exposure of U.S. banks in non-oil developing countries, which totalled $111 billion as of the end of 1980. U.S. non-banks have relatively few claims on LDCs; after exclusion of financial claims on the Bahamas and British West Indies, where U.S. firms have financing and "captive insurer" subsidiaries, the total is under $7 billion. These non-bank claims are primarily trade receivables; they exclude direct investments, which are outside the scope of this study as they represent equity rather than debt claims.

The following description of U.S. bank exposure in non-oil LDCs is drawn from the semi-annual Country Exposure Lending Survey compiled from reports filed with the Comptroller of the Currency, the Federal Reserve and the Federal Deposit Insurance Corporation.* The Survey covers large U.S. chartered banks having significant foreign banking operations (about 150 out of 14,000 commercial banks) and consolidates claims of the head office in the United States and those booked at overseas offices. It is limited to "cross border, non-local currency" claims, thus excluding any lending by an overseas office located in a LDC to residents of that country which is denominated in that country's currency. Such local currency loans are not considered to be subject to "country risk" because the borrower does not have to generate foreign exchange to repay them; they are in any event relatively insignificant in LDCs. Claims of U.S. offices of foreign chartered banks are not included.

* These agencies have jurisdiction over national banks, state-chartered member banks, and insured non-member banks, respectively.

A bank's exposure, or risk, in a country differs from the volume of outstanding claims on that country and is defined in various ways depending on the purpose. Outstanding claims represent the borrower's existing (disbursed) debt to the bank; changes in the level of claims represent actual credit flows. Exposure is the amount a bank could potentially lose if Country X defaulted on its obligations. It includes all outstanding claims, less those guaranteed by the residents of other countries (including U.S. residents), plus the amount of the bank's loans to other countries that are guaranteed by residents of Country X. Alternatively, it is often defined, as in this study, to also include the amount of commitments to lend to that country, adjusted to reflect the country of guarantor.

2. Exposure by Class of Bank

Two-thirds of aggregate exposure in non-oil LDCs is accounted for by the nine largest reporting banks. (See Table 12.) The next fifteen largest and the remaining (129 as of end-1980) banks each account for one-sixth of the total. Commitments are relatively more significant for the nine largest banks but overall account for just one-fifth of aggregate exposure. The Latin America/Carribbean region, which accounts for over half of aggregate exposure, is particularly attractive for the medium and smaller banks.

Table 12

Total Exposure in Non-oil LDCs -- By Size of Bank
($ billions)

	Increase			Outstanding
	1978	1979	1980	12/31/80
Nine Largest	7.7	10.2	11.9	74.6
Next Fifteen	1.5	2.1	3.8	19.0
Remaining	1.3	2.6	3.6	17.8
All Reporters	10.5	14.9	19.4	111.4

This exposure needs to be judged against the balance sheets of the lending banks. As shown in Table 13 below, lending to LDCs by the larger banks is substantially higher relative to their capital and accounts for a greater proportion of their total assets. (Large banks are generally more leveraged than small banks.) The table also shows the rise in relative exposure since 1977.

Table 13

Exposure in Non-oil LDCs Relative to Capital and Assets
By Size of Bank*

	end of year ratio			
	1977	1978	1979	1980
Exposure in LDCs ÷ Capital				
All Reporters	1.6	1.7	1.8	2.0
Nine Largest Reporters	2.4	2.6	2.9	3.1
Next Fifteen	1.4	1.5	1.5	1.7
Remaining	0.7	0.7	0.8	0.8
Exposure in LDCs ÷ Total Assets				
All Reporters	0.09	0.09	0.10	0.10
Nine Largest Reporters	0.12	0.12	0.13	0.14
Next Fifteen	0.08	0.08	0.08	0.09
Remaining	0.05	0.05	0.05	0.05
Total Assets ÷ Capital				
All Reporters	17.5	18.1	18.9	18.7
Nine Largest Reporters	20.2	21.1	22.2	22.1
Next Fifteen	17.5	18.4	18.6	18.2
Remaining	14.1	14.2	15.0	15.2

* Capital is defined as equity capital plus subordinated debentures and loan loss reserves.

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3. Exposure to Major Borrowers

U.S. banks' lending to LDCs is heavily skewed toward a group of relatively advanced countries which depend largely for external finance on credit from private sources. (See Table 14.) Traditional ties with Latin America, stemming largely from geographical proximity, are reflected in greater exposure of U.S. banks in this area compared to the lending pattern of non-U.S. banks.

Table 14

Exposure of U.S. Banks to Non-oil LDCs: end-1980

	in $ billions	ratio to banks' capital
All Areas	$ 111.4	1.95
Latin America & Caribbean	$ 60.9	1.07
Asia	30.5	0.54
Africa	5.0	0.09
Offshore Banking Centers*	15.0	0.26
		as percent of all LDCs
of which:		
Mexico	19.4	17.4%
Brazil	17.7	15.9
Korea	9.9	8.9
Argentina	8.7	7.8
Taiwan	6.3	5.7
Philippines	5.7	5.1
Hong Kong	4.7	4.2
Chile	4.5	4.0
Colombia	3.7	3.3
Thailand	2.3	2.1
Israel	2.3	2.0
Peru	2.2	2.0
TOTAL	87.4	78.5

* Bahamas, Bermuda, British West Indies, Hong Kong, Lebanon, Liberia, Macao, Netherlands Antilles, Panama and Singapore.

[Note: A large portion of outstanding and contingent claims on offshore banking centers entail funds lent to foreign banks that are on-lent to other areas; these are excluded from the definition of "exposure" used in this section.]

4. Maturity of Lending and Nature of Borrowers

The tenor of loans to LDCs shortened considerably in 1979 and 1980, and at the end of the period over sixty percent of outstanding claims (by country of residence) had a maturity of one year or less. (See Table 15.) This trend reflected a surge in LDC borrowing needs and the reluctance of banks to commit themselves for term credits when concerns over the prospects for "recycling" had increased. Borrowers, for their part, were reluctant to borrow long-term funds, given the level of interest rates and fees. Funds were obtainable only at a much higher cost (in terms of a spread over LIBOR*). (This trend was reflected as well in the decline in LDC issues of bonds during 1979 and 1980, including those in the form of floating rate notes.)

Table 15

U.S. Bank Claims on Non-oil LDCs: By Remaining Maturity

	Increase 1978	Increase 1979	Increase 1980	Outstanding 12/31/80	Outstanding 12/31/80 % of total
	$ billions				
1 year and under	2.9	7.7	11.7	46.4	(61.5%)
Over 1 to 5 years	0.6	0.9	-0.2	20.6	(27.3%)
Over 5 years	1.8	1.0	2.0	8.5	(11.3%)
TOTAL, Excluding Banking Centers	5.3	9.6	13.6	75.4	(100.0%)
Claims on Non-banks in Banking Centers	1.6	0.8	1.3	9.0	
TOTAL	6.9	10.4	14.9	84.4	

* London Interbank Offer Rate

Three groups of foreign debtors -- banks, public sector and non-bank private borrowers -- now share fairly evenly in the total claims of U.S. banks. (See Table 16.) Lending to the private non-bank sector rose quite sharply in 1980, primarily reflecting transactions vis-a-vis Mexico. However, lending to banks, also includes funds provided primarily for on-lending to the public and private non-bank sectors.

Table 16

U.S. Bank Claims* on Non-oil LDCs: by Nature of Borrower
($ billions)

	Increase			Outstanding	
	1978	1979	1980	12/31/80	(% of total)
On Banks	$4.8	$4.3	$4.3	$26.4	(35.0%)
On Public Borrowers	0.4	2.5	3.2	22.5	(29.9%)
On Other Private	0.0	2.8	6.1	26.5	(35.1%)
TOTAL, Excluding Offshore Banking Centers	$5.3	$9.6	$13.6	$75.4	(100.0%)

* By country of residence not country of guarantor

5. U.S.G. Guarantees of Commercial Bank Claims

U.S. banks' exposure is shown in Table 14 above after adjustment to reflect guarantees by third parties, including guarantees by the U.S. Government. Rough estimates indicate that about 20% of the total guarantees of bank claims (outstanding claims and commitments) are accounted for by the USG. Eximbank programs are by far the largest both in terms of amount and number of countries having such guaranteed loans. Guarantees to LDCs under CCC programs existed as of end 1980 only for the Dominican Republic, Korea, Peru and Sudan. OPIC and AID Housing Guarantee programs are not handled through commercial banks for the most part;

the only significant U.S. banks claim under these relate to Zambia ($29.4 million under OPIC).

It is not possible to determine the amount of guarantees of claims on an individual country that have been provided by all U.S. residents (private as well as USG). Federal Reserve staff believe, however, that the volume of guarantees provided by private U.S. entities is relatively small.

Table 17

Guarantees of U.S. Bank Claims on Non-oil LDCs
(Excluding Off-shore Banking Centers)

position as of end-1980

		$ billions
Total U.S. Bank Claims and commitments by Country of Residence		96.3
of which:	guaranteed by third parties	6.8
of which:	estimated guarantees extended by USG 1/	2.4
	EXIM	(2.0)
	CCC	(0.4)
	OPIC	(*)
	FAA	(*)

* less than $500 million

6. Exposure Risks

The pattern of external financing of LDCs shifted in the preceding decade as some of these countries' economies matured and the volume of aggregate payments deficits outgrew the capacity of official sources to finance them. This trend created new opportunities for private banks. U.S. banks have been in the forefront, and realized substantial profits as few losses have occurred. (U.S. banks' losses in international

1/ Estimates differ from reported total contingent liabilities of the USG since the latter include guarantees of credits extended by entities other than banks and may not coincide with actual transactions of banks.

lending have been concentrated in developed countries, reflecting commercial risk rather than sovereign or "country" risk.) An increase in risk, represented by the growing volume of claims on LDCs in banks' balance sheets, is the logical counterpart of these enhanced opportunities, but the principles of banking require that risks be kept within prudent bounds.

Bankers and bank supervisors have considerable experience in assessing the commercial viability of a project financed by a loan, but the risk that a country will be unable or unwilling to make available foreign exchange to repay a loan is much more difficult to assess. In principle, this risk -- to which must be added commercial risk if the loan is to a private entity in the LDC -- is assumed to be a fairly small one since countries cannot "go out of business", and instances of outright debt repudiation have been rare. But temporary difficulties which impede the scheduled servicing of a country's external debt are not rare and have a real cost: the bank's liquidity is reduced and it may have to make provisions for a loss which, even if ultimately avoided, can affect current income.

Prudent practices dictate the avoidance of excessive country risk.

Diversification of lending risks is the central means of minimizing them. This principle is reflected in the statutory limit (for national banks) on lending to any one customer or borrowing entity equal to ten percent of a bank's unimpaired capital plus surplus.* Although this limit applies to lending

* The Comptroller of the Currency has interpreted this limit as applying to the aggregate of loans to a foreign government and its entities to the extent that an entity does not have independent means to repay a borrowing or does not apply the proceeds to a purpose independent of the central government's functions.

to foreign governments, there is no such limit on overall lending to any country.

In 1978 the bank regulatory agencies agreed on a uniform system for assessing country risk and bringing to the attention of banks' management concentrations of country risk that are large relative to the strength of the country. Banks are, however, free to lend amounts in excess of the exposure levels which give rise to comment by bank examiners, and routinely do so. The purpose of the system is not to impose rigid limits but rather to ensure that banks monitor country risk and have internal procedures to incorporate their assessment in lending decisions.

IV. U.S. Policies and Procedures

A. Statutory Responsibilities and Congressional Interest

Neither the Constitution nor any federal law assigns to any Executive Branch Department explicit authority to reschedule foreign debt owed to the USG. However, the Treasury Department has broad responsibilities to ensure that the collection and disbursement of public funds is accomplished in a financially prudent manner, and the State Department has broad responsibilities to manage the foreign relations of the U.S.

Most loans from the USG to foreigners are made by agencies established by the Congress to manage foreign lending programs. These agencies are the Agency for International Development (AID), the Commodity Credit Corporation (CCC), the Defense Security Assistance Agency (DSAA), the Export-Import Bank, and the Overseas Private Investment Corporation (OPIC).* Generally speaking, the laws governing the lending operations of these agencies provide explicit authority to adjust the terms of loans after they have been made. In 1970, the Attorney General issued an opinion on a debt-rescheduling arrangement with Indonesia that clarified the limits of this authority. According to this opinion, the Executive Branch has considerable flexibility in renegotiating terms, especially when the borrowing country is in a situation of default or imminent default.

Apart from its broad responsibilities, there are a number of specific statutory responsibilities assigned to the Executive Branch or to individual agencies. A few of these are described below:

* In addition to direct loans, some of these agencies also guarantee loans extended by commercial banks.

-- A provision of the Foreign Disaster Assistance Act of 1974 requires the Secretary of State to keep Congress informed of any debt rescheduling negotiations, and to transmit the text of any U.S. bilateral debt relief agreement to Congress thirty days before it becomes effective. (The "Wolff Amendment".) State drafts the letters to Congress pursuant to this provision (as well as drafting the bilateral agreements) and clears them with the agencies concerned.

-- A provision of the International Development and Food Assistance Act of 1978 requires the Chairman of the Development Coordination Committee (presently the head of IDCA) to make an annual report to Congress which addresses, among other subjects, the debt-servicing capacity of countries receiving foreign aid from the U.S., and any debt relief provided by the USG. Treasury has drafted the portions of the report that deal with these subjects. In addition, Treasury provides quarterly reports to Congress pursuant to this provision on: (a) active foreign credits; (b) amounts due and unpaid 90 days or more; (c) significant arrearages; and (d) contingent foreign liabilities.

-- Since 1976, appropriations legislation for foreign aid has contained a provision cutting off aid to any country that is in default on a foreign aid loan from the USG for more than one year. (The "Brooke" Amendment.) Treasury obtains quarterly information on arrearages from creditor agencies and provides information on the status of arrearages at weekly meetings of the National Advisory Council Staff Committee.

-- A provision of the Foreign Assistance Act of 1961, as amended, prohibits "writing off" any liabilities arising from FAA loans. (The "Dirksen Amendment".) This was supplemented by a provision of the International Development and Food Assistance Act of 1975 that no FAA debt "may be settled in an amount less than the full amount" unless approved in a concurrent resolution of the Congress.

-- The Foreign Assistance Act of 1974 required that all future amortization and interest payments on FAA loans be deposited in the Treasury instead of being used by the lending agency for relending. This had the effect of sharpening the distinction between debt relief and aid, and of giving Treasury and State greater responsiblity for debt-relief negotiations.

-- In 1978, an amendment to the Bretton Woods Agreement Act requires the U.S. Executive Director in the IMF to seek to assure that IMF resources are not used to undercut the U.S. policy of obtaining "comparable treatment" of private and public creditors in debt relief arrangements. (The "Cavanaugh" Amendment.)

Congressional interest in U.S. debt policy continues to be substantial. However, hearings on debt and debt policy have not been held since February 1979 when Assistant Secretary Bergsten (Treasury) and Assistant Secretary Katz (State) testified before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee. The Subcommittee was chaired by Senator Harry Byrd of Virginia.

B. Delinquent Foreign Debts

Since 1970, the U.S. Government has adopted relatively rigorous procedures for identifying and eliminating delinquent payments. To begin with, each creditor agency is responsible for notifying any borrower that fails to make a payment by the due date. When this notification fails to eliminate the delinquency, the problem is brought to the attention of the State Department. A cable is sent to the U.S. Embassy in the debtor country requesting the Ambassador to bring the problem to the attention of the host government and ascertain the nature of the problem. Further steps are considered in light of the Embassy's report. In some cases, disbursement of new credits is suspended pending correction of the delinquency. In others, new credits continue flowing because important U.S. interests would be affected adversely if new credits were cut off.

There is a formal reporting system that supports these procedures. The Treasury Department publishes a set of four quarterly reports:

(1) Status of Active Foreign Credits of the U.S. Government;

(2) Amounts Due and Unpaid 90 Days or More;

(3) Significant Arrearages by Official Foreign Obligors; and

(4) Contingent Foreign Liabilities.

These reports are widely distributed to the Departments and Agencies concerned, to Committees and Members of the Congress, and to libraries and other interested institutions.

The interagency body that addresses policy issues relating to arrears is the National Advisory Council (NAC) on International Monetary and Financial Policies, chaired by the Secretary of the Treasury. The members of the NAC are Treasury, State, Commerce, USTR, IDCA, Eximbank, and the Federal Reserve Board. There are weekly meetings of the NAC, at the staff level, at which specific credits are reviewed prior to being extended by the agencies concerned. Currently, the NAC Staff Committee reviews most Eximbank and Agriculture Department credits. Although the NAC is empowered by the relevant Executive Order (E.O. No. 11269 dated 14 February 1966) to address any significant policy issues relating to credits extended by other agencies, credits extended by A.I.D. and the Defense Department are reviewed in other interagency bodies. For example, A.I.D. loans are reviewed in the Bilateral Aid Subcommittee of the Development Coordination Committee (DCC). Each weekly meeting of the NAC Staff Committee begins with a report on the arrearage status of the countries receiving the credits to be reviewed in that week's meeting.

In 1971, the NAC adopted a statement of policy on arrearages. The heart of this statement is the following two sentences: "As a general policy, the Council recommends that loans to countries whose government are in arrears 90 days or more on debts which they or their agencies owe to the U.S. Government or its agencies should be deferred and, where appropriate, disapproved. Exceptions to this general rule must be explicitly approved." A policy statement on standard procedures for collecting arrearages was adopted in 1976. Also in 1976, the NAC established a Working Group on Arrearages, chaired by Treasury, to submit reports on arrearages to the NAC Staff Committee and to make recommendations on courses of action to resolve arrearage problems. (The relevant NAC Actions are continued in Appendix C) At the present time, the Working Group on Arrearages is inactive, and the procedures for collecting arrearages are being followed loosely because the agencies place a low priority on this activity. The general policy on deferring new loans to countries in arrears is usually not followed, since exceptions are routinely approved by the NAC and WGMA agencies.

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C. Debt Relief

In 1978, the National Advisory Council adopted a statement of U.S. policy on multilateral debt re-organization. (Appendix D.) The three key elements of the policy are that:

(a) debt relief will be granted only on a case-by-case basis in situations of default or imminent default (it will not be granted as a form of development assistance);

(b) to qualify for debt relief, the debtor country must implement an economic program designed to re-establish its creditworthiness; and

(c) the terms of debt relief will be arrived at through multilateral negotiations.

The NAC policy statement was precipitated by Congressional considerations of legislation authorizing U.S. participation in the Supplementary Financing Facility of the IMF. Congressman Cavanaugh had introduced amendments designed to preclude any "bail-out" of commercial banks by the U.S. Government (or the IMF). The policy statement was part of a successful effort to obtain an "acceptable" Cavanaugh amendment. It should be emphasized, however, that the NAC policy statement did not represent a new policy but simply a formal statement of policy that had been evolving over about twenty years. Prior to 1978, the only significant exceptions to the stated policy were: (a) a series of debt-relief operations (1968-74) involving India in the absence of a default situation; (b) bilateral arrangements with Yugoslavia (1971), Egypt (1971), and Poland (1973); and (c) the January 1981 operation with Pakistan in the absence of a default situation.

The current interagency approach to debt-rescheduling negotiations has its origins in an elaborate policy exercise that began in 1974. Executive Branch interest in debt-relief was heightened by the oil-price shock of 1973-74, and by debt-relief operations involving India, Pakistan and Zaire. The State Department took the initiative and sought a cabinet-level decision that would provide greater flexibility in the use of debt relief and confer upon State the leading role in implementing debt policy. Treasury resisted, and in January 1974 Secretary Schultz asked President Nixon to assign Treasury clear responsibility for debt rescheduling issues. President Nixon kicked the issue back to the Cabinet.

Later in the year, Secretary Simon worked out an arrangement with Secretary Kissinger. The State Department would represent the USG in debt-rescheduling negotiations. (The Treasury Department and the major creditor agencies are often included in the delegation to the negotiations.) The Treasury Department would take the lead in formulating the negotiating position, and obtaining interagency clearances through the National Advisory Council.

This quid pro quo arrangement has endured over the last seven years. In practice, State and Treasury have worked closely and harmoniously at both the staff and policy levels. The Office of Developing Nations Finance drafts a position paper setting forth the maximum package of terms acceptable to the U.S. An economic analysis which shows that the preconditions for debt relief have been met is part of the paper. This draft is sent to the Office of Monetary Affairs in the Economic Bureau at State, and the two offices work toward a cleared State-Treasury position, resolving issues at higher levels as necessary. While the paper is in preparation, Treasury also consults the principal lending agencies for their views. The cleared paper is circulated to the NAC agencies for a discussion and a vote. Other agencies rarely object to the cleared position.

V. Areas of Policy Concern

A. Official Credits

1. Lending to Uncreditworthy Countries

A policy issue that has arisen repeatedly in recent years has been the extension of loans by USG agencies to countries which were already unable to meet their existing debt-service obligations to the USG. For example, the Eximbank extended loans to Turkey after the U.S. had participated in a multilateral debt relief operation. Three-year CCC guaranteed credits were extended to Poland at a time when there was considerable evidence that Poland would have recourse to debt relief within a year or two. Direct military credits have been extended to Sudan following debt relief operations, and these have the additional disadvantage of not contributing to the productive capacity of the economy. Guaranteed military credits at non-concessional interest rates have also been extended to Zaire, even though it is highly probable that the guarantees will be called and some of the payments due will be rescheduled.

In virtually every case of this kind, assistance has been extended on financially inappropriate terms because the U.S. had strong political interests in assisting the country, and there were legislative constraints to extending assistance on grant or highly concessional terms.

2. Approaches to Countries with "Prolonged" Debt Crises

The procedures that have evolved over the past two decades for official debt-relief operations are notably successful in cases like that of Peru in 1978, where the crisis developed rapidly and there was a government in control that could implement the economic reforms necessary to stabilize the economy in a short (1-3 year) period of time. The procedures are distinctly less effective when the debt crisis builds up over a period of years and the government pursues stabilization in a desultory fashion. The problem in a nutshell is that debt relief cannot resolve a debt crisis; it takes appropriate economic policies. In fact, in the absence of the right policies, debt relief tends to exacerbate the debt problem by relieving pressure for economic reforms while adding to the country's debt-servicing burden.

We faced this dilemma squarely in the 1980 debt-relief operation with Turkey, and the 1981 operation with Zaire. We will face it again in early 1982 with Sudan. In 1980, the creditor countries initially made a generous offer of debt relief to Turkey: 90 percent of principal and interest payments during the next year would be rescheduled -- excluding payments required under the 1978 and 1979 rescheduling arrangements. The Turks refused the offer on the grounds that they would have to default on some payments to official creditors unless they received more relief. A presidential decision to make a more generous offer was requested by State. It was supported by Treasury, but opposed by OMB. The President authorized the rescheduling of 1978 and 1979 previously-rescheduled debt, and a new creditor-country offer was made that the Turks accepted. Rescheduling previously-rescheduled debt is an undesirable precedent, especially because it discourages other countries from honoring their initial debt-relief agreements.

In July 1981, a U.S. delegation went to Paris to negotiate a debt-relief arrangement with Zaire and had instructions to oppose rescheduling of previously-rescheduled debt for 1981, with the expectation that a subsequent arrangement for 1982 would have to include previously-rescheduled debt (PRD). The GOZ made a strong case for receiving some relief on PRD immediately and other creditors supported this action. The U.S. was isolated and eventually agreed to the inclusion of PRD in 1981, but not in 1982. Now, however, there appears to be a strong likelihood that this two-year agreement will have to be renegotiated to include some relief on PRD in 1982.

Rescheduling negotiations with the Sudan are tentatively scheduled for February 17-18. Sudan has a debt situation almost as bad as Zaire's, and will probably make a strong case for rescheduling some PRD relating to the 1979 operation.

In each of these three cases, there is evidence that the initial debt relief arrangements, by their nature, helped to prolong the country's debt crisis. The common defect seems to be that the repayment terms on the debt relief were set before the country's B/P situation had stabilized, and it was really not possible to predict when stability would be restored.

A recent Treasury staff study explored alternatives to the conventional approach that might prove to be more effective in dealing with "prolonged" debt crises. One alternative that appears to have some merit is to "defer" or "roll-up" debt-service payments one year at a time, and to delay negotiating the final repayment schedule for these amounts until the crisis has passed. In each successive year, creditors would also seek to reduce the proportion of rescheduled payments that would be deferred.

While this alternative has some attractions from a financial point of view, it does present some possible legal or contractual complications. Moreover, it does not come to grips with the political dimension that makes these prolonged cases so complicated. Specifically, in each of these three cases (Turkey, Zaire and Sudan), the ability of the government to implement effective stabilization measures is hampered by political weakness. At the same time, the western creditors have strong strategic interests in each country which make them reluctant press hard enough to make effective stabilization a precondition for assistance.

3. Preferred Status for USG Agencies

From time to time, there have been attempts by U.S.G. agencies to claim preferred status as creditors, or to exclude specific credits from debt-relief arrangements. For example, Eximbank credits to the Southern Peru Copper Company were excluded from the 1978 rescheduling arrangement with Peru. The NAC agencies agreed to this exclusion basically because it appeared to be in the interest of Peru together with its creditors to exclude them.

In other cases, Eximbank has conditioned its financing upon the establishment of "off-shore escrow accounts" designed to prevent any interruption in debt-service payments from the borrower even if it experiences critical debt-servicing difficulties.

The NAC agencies have refused to agree *ex ante* that loans having special security arrangements of this type would be excluded from future rescheduling operations. Rather a NAC Action was adopted (Action 78-515, 6 November 1978) that provides for NAC consideration of the issue when a negotiating position for a specific rescheduling operation is being reviewed.

OPIC has also claimed preferred status in some recent cases, notably in the 1978 rescheduling operation with Turkey. In this case, the issue is complicated by a formal arrangement between OPIC and the Department of State that makes available to OPIC dollars that would otherwise be used by State to buy local currencies -- when an OPIC borrower is unable to obtain dollars from its central bank to meet its obligations to OPIC.

4. Interest Charges on Rescheduled Debt

Until 1981, the practice of the U.S.G. was to charge interest on rescheduled debt on the same basis used to determine interest on the original loans. This meant that interest charged on rescheduled concessional loans (AID and PL480) was fixed at 2-4 percent per annum, while interest on rescheduled *non-concessional* loans was fixed at the current lending rate of the agency (Eximbank, CCC, or DOD).

In 1981, largely in connection with the Poland rescheduling operation, the agencies that extend non-concessional loans changed their practice. First, they set the interest charged on rescheduled loans at their *marginal cost of funds*, which tended to be significantly higher than their normal lending rates, because of the subsidy element in their lending operations.

Second, they made the rates variable at six-month or annual intervals.

These changes have given rise to several policy concerns. To begin with, the changes are viewed by the debtor countries as being onerous, and the negotation of bilateral implementing agreements has been considerably delayed in some cases over this issue. Along the same lines, it can be argued that the higher rates associated with this practice serve to make it harder for the debtor country to overcome its debt-servicing difficulties. In short, the practice on interest rates conflicts with the basic objective of granting debt relief. This aspect could be especially important if all creditor countries were to adopt the same practice.

So far, the method of setting interest rates for debt relief on concessional loans has not changed. However, USDA has expressed interest in charging the marginal cost of funds to the CCC on such relief.

5. Debt Relief as a Substitute for Aid

For several years in the late 1960s, the U.S. extended debt relief to India even though India was not experiencing debt-servicing difficulties. In this case, debt relief was a substitute for aid, which had the advantage from the U.S. point of view of not requiring congressional appropriations, and from the Indian point of view of being totally untied and "fast-disbursing" B/P financing. In order to avoid Congressional criticism for extending "backdoor assistance", the Executive Branch adopted in the early 1970s a firm policy against the use of debt relief for aid. This kept the U.S. out of several more negotiations with India in which other OECD creditors provided debt relief.

The policy against debt relief in non-default situations has been tested several times. So far, only one exception has been made. In 1981, the U.S. participated in an extraordinary debt relief operation with Pakistan. In mid-1980, there had been a Presidential decision to participate in such an operation as an exception to U.S. policy on the condition that Pakistan enter into an upper credit tranche arrangement with the IMF designed to support broad policy reforms. The exception was granted at a time of great concern over the Soviet invasion of Afghanistan, and when certain Congressional prohibitions relating to nuclear facilities and an earlier rejection of military assistance impeded an offer of direct U.S. assistance to Pakistan. Considerable care was taken to minimize the damage this operation could create as a precedent for providing debt relief to other countries in non-default situation (i.e., by negotiating in the aid consortium instead of the Paris Club, and by limiting the relief to aid loans). Nevertheless, if this kind of an operation is repeated in the near future, the damage could be considerable in view of the pressure in this direction exerted by the UNCTAD Secretariat and the G-77 (see Section V. C. 4.).

6. Debt Relief from Non-traditional Creditors

Until the mid-1970s, lending to LDCs by governments of non-OECD countries was relatively insignificant. Since then, however, several LDCs have emerged as major creditors to countries experiencing critical debt-servicing difficulties. Notable among these cases are Saudi Arabia and Kuwait as creditors to Sudan, Brazil as a creditor to Poland, and Tanzania and Zambia as creditors to Uganda. In the 1978 Paris Club operation for Peru, the traditional OECD creditors deliberated the pro and cons of inviting non-traditional creditors to Paris Club negotiations. They decided to adopt as a practice extending invitations to all major creditors. Since then, Saudi Arabia and Kuwait have sent observers to several Paris Club negotiations, but no non-traditional creditors have participated fully in such negotiations.

Related to the issue of participation in the negotiations is the issue of adherence to the most-favored nation principle embodied in all Paris Club agreements. There is some evidence that non-traditional creditors have been treated as preferred creditors. However, further study would be necessary to determine if preferred treatment is a significant problem.

B. Private Capital Flows

1. Relationship of Official and Private Debt Relief

While official and private lenders have substantially different interests to protect when responding to countries seeking debt relief, they have one overriding interest in common: facilitating the economic recovery of the borrower. As a result, there is usually a fairly close but informal exchange of views on the nature and extent of the borrower's debt problem between private and official creditors.

In some cases, countries seek debt relief from private (bank) creditors or official creditors, but not both. For example, in the cases of Bolivia and Jamaica, only banks extended debt relief. On the other hand, only official creditors extended debt relief to Madagascar and Uganda. In most cases, however, both official and private lenders have extended debt relief through separate and essentialy uncoordinated negotiations. Several concerns have arisen in these cases. First, some debtor countries have argued that the separate negotiations make it difficult to reconcile the competing claims of their creditors while at the same time attempting to strengthen their balance of payments situation. Second, official creditors have been concerned that their relief was being used to "bail out" private creditors. Third, private creditors have been concerned over perceived pressure from the official creditors to extend "more generous" debt-relief terms to the debtor country.

At the heart of these concerns lies the concept of "comparable treatment". This is the notion that a debtor country seeking debt relief should not confer upon any category of creditor (with the exception of multilateral official institutions) a preferred status -- by giving one category a prior claim on its scarce foreign exchange resources. In short, all creditors should be treated equitably. The term "comparable treatment" is now found both in the standard language of Paris Club debt-relief agreements and in a formal statement of U.S. policy.

U.S. policy on comparable treatment was formalized in 1978 when the NAC adopted a statement of policy on debt reorganization. The event precipitating the statement was Congressional action authorizing U.S. participation in the IMF's Supplementary Financing Facility. Specifically, Congressman Cavanaugh charged that the Executive Branch was prone to use debt relief to "bail out" commercial banks that had made imprudent loans to developing countries. The Administration responded that existing policies were designed to avoid actions of this nature, and transmitted to the Congress the text of the NAC Action.

The earliest case when comparable treatment arose as a serious issue occurred in connection with a series of Paris Club negotiations with Zaire in 1976-79. Commercial bank exposure in Zaire was around $500 million, and yet the banks (led by Citibank) argued vehemently that they should not be required to extend debt relief to Zaire. By 1979, the official creditors took a firm position that they would not provide further debt relief to Zaire without "comparable" action by the banks. In late 1979, a debt-relief agreement with the banks was concluded, and a new Paris Club meeting was held shortly thereafter.

By contrast, a high degree of comparable treatment was achieved in the 1978 debt relief negotiations with Peru. The commercial banks set the pace by concluding a refinancing agreement covering 90 percent of the principal payments falling due in 1979 and 1980. These amounts were to be repaid in seven years including a three-year grace period. Subsequently, official creditors concluded a debt relief agreement with Peru on virtually the same terms.

More recently, the U.S. had some concerns about comparable treatment in the official debt relief negotiations with Turkey in 1980. Treasury prepared a limited quantitative analysis of the debt-relief arrangement proposed for official creditors to determine what amount of refinancing or new lending by commercial banks would be necessary to achieve comparability. Assuming the ratio of exposure before and after debt relief should be the same for both categories of creditor, the analysis concluded that an increase in bank exposure of around $350 million, over existing exposure of $6.5 billion, would be necessary. However, other equally valid approaches would have yielded different conclusions. The lesson drawn from this experience was that there is no single quantitative test of the comparability of private and official debt relief arrangments.

Comparable treatment is presently an issue in the cases of Poland, Sudan and Liberia.

2. Lending to Uncreditworthy Countries

From a prudential viewpoint, U.S. banks should not -- and for the most part do not -- lend to uncreditworthy countries. There are, however, instances of management error. It would be a violation of prudent banking practices and of stockholder interests if a bank extended credit which it had reason to believe could not be serviced as scheduled. Although the U.S. Government has a role in regulating banks, it is U.S.G. policy not to intervene in the lending decisions of private banks in order to achieve foreign policy goals, nor to attempt to influence commercial judgements.

The bank regulatory agencies do, however, seek to ensure that banks undertake country risk appraisal and are aware of significant concentrations of exposure. In 1979, these agencies adopted a uniform system to measure exposure by country of risk, to assess management systems to monitor exposure and to bring to the attention of bank management any cases of significant concentrations of exposure relative to capital. A threshold of 25 percent kof capital applies for lending to the strongest countries, and lesser concentrations trigger notification for two other categories of countries. These thresholds do not constitute limits; many banks maintain larger concentrations for particular countries.

Determination of "creditworthiness" by the banks is a complex process often involving heroic assumptions about the future course of a country's political structure and economic policies. When problems arise, banks try to formulate a strategy maximizing their total repayments, in which they must balance the attractions of reducing exposure as rapidly as possible against their interest in maintaining a good client relationship and in protecting their competitive position vis-a-vis other banks. Thus, it would often be in the interest of a bank to accept a restructuring of its claims on a country -- or even to increase its exposure -- in order to give the country time to adopt and implement appropriate policies.

If a borrower fails to service its debt in a timely manner, banks must place loans on a current rather than accrual basis, meaning that interest cannot be taken into income as it is earned but only if and when actually paid. In the absence of indications that there is a likely prospect that a debtor country will be able to repay its debt, banks have to treat their claims on the borrower or on residents of that country as being unsound. Internal procedures, review by independent auditors and examination by supervisory authorities would impell the establishment of reserves against possible losses. Reserves can be either general or applied against specific loans. In either case, income is reduced. While the bank's equity capital and surplus position is affected by the loss of income (unless dividends are reduced), its overall capital position is not necessarily affected by the lodging of loan loss provisions since these are frequently included in the definition of capital. If and when the affected loans are ultimately repaid, there would be a corresponding increase in income and equity capital.

3. Recycling

Higher oil prices, and a tendency to give investment and consumption priority over external equilibrium, have resulted in a substantial increase in LDC current account deficits. LDCs have also sought to build up reserve holdings where conditions permitted. Consequently, LDC demand for external financing rose sharply from 1974 through the present albeit with some respite in the middle of this period. Development assistance flows could not keep pace with demand, and it was inevitable -- and desirable -- that private sources provide the bulk of the increased flows. The low level (through 1980) of recourse to the International Monetary Fund, which provides mainly short-term balance of payments financing, also attests to the relative ease with which "recycling" has been carried out. (At the same time, such financing is obtained without the conditionality attached to IMF credit.)

Table 18 provides an overview of the channels through which LDCs have been financed. Private flows account for two thirds of total requirements, and bank lending makes up most of this. The share of U.S. banks in total outstanding bank claims on LDCs is around 40 percent.

From a systemic point of view, there is a concern that recycling in the 1979-81 period has been too easy. The abundance of external funds available at relatively low real rates of interest may have encouraged a large number of countries to delay economic adjustments. As a consequence, the adjustments necessary at this stage are more far-reaching and difficult ones. This also increases the probability that individual countries will experience critical debt servicing difficulties. A corallary concern is that there will be too little recycling to LDCs in the 1982-83 period if OPEC surpluses are small and demand for imports in the industrial countries remains soft.

TABLE 18

NET EXTERNAL FINANCING BY NON-OPEC DEVELOPING COUNTRIES IN DEFICIT
($ billions)

	1978	1979	1980	1981 (Proj.)
FINANCING REQUIREMENTS	$36	$44	$55	$63
--Aggregate Current Account Deficits including official transfers of:	26 (-13)	38 (-16)	54 (-18)	63 (-20)
--Increase in Reserves	10	6	1	0
******				
SOURCES OF FINANCING	40	51	57	66
Recorded Private Flows, Total	28	37	40	45
--Net Borrowing from Banks	20	28	32	35
-Increase in indebtedness to banks 1/	(23)	(32)	(37)	(39)
-Less: increase in claims on banks 2/	(3)	(4)	(5)	(4)
Memorandum: Gross Medium-term Syndicated Credits	[19]	[29]	[26]	[37]
--Issue of Bonds, net of redemption	2	2	1	2
--Net Direct Investment	6	7	7	8
Official Flows other than IMF	11	12	14	16
--Bilateral Loans and Credits	6	6	7	8
--Multilateral Loans and Credits	5	6	7	8
IMF Flows	1	2	3	5
--SDR Allocations	0	1	1	1
--Trust Fund Loans	1	1	1	0
--Net IMF Credit	0	0	1	4
-Gross Drawings	(1)	(1)	(3)	(6)
-Less: Repurchases	(1)	(1)	(2)	(2)
******				
RESIDUAL (Unrecorded net outflows and estimating errors)	4	7	2	3

1/ including officially guaranteed credits extended through banking system, the exact extent of which cannot be specified from available data but which may comprise around ten percent of the total.
2/ excluding estimated holdings of reserves in banks.

Treasury: OASIA/IDN-IMB-IMA
10/27/81

C. The Roles of the International Institutions

1. Participation of MDBs in Offical Debt Relief Operations

By tradition, international organizations, including the MDBs, have been exempted from participation in multilateral rescheduling operations with official creditors. Thus, they have been granted the status of "preferred" creditors. With regard to the MDBs, this has been viewed as being in the mutual interest of creditors and debtors because: (a) non-participation has enhanced the creditworthiness of the MDBs and contributed to their ability to borrow in private capital markets on very favorable terms and, hence, to lend to LDCs on relatively favorable terms; and (b) non-participation has made it easier for donor countries to obtain domestic political support for capital increases and replenishments for the MDBs*; and (c) non-participation has allowed the MDBs to continue their lending programs in countries with critical debt-servicing difficulties.

To date, non-participation has not presented problems in any particular operation. However, this appears due in part to the fact that multilateral exposure has been small relative to bilateral exposure. Recently, MDB lending has grown much more rapidly than bilateral lending, grace periods on earlier loans are ending, and interest rates (although still subsidized) have risen somewhat in line with the MDBs own borrowing costs. There are now a number of countries in which multilateral exposure exceeds bilateral exposure (see Table 19). Should one of these countries experience critical debt-servicing difficulties, it may not be

* In the case of the U.S., this is a particularly important Congressional consideration with regard to U.S. subscriptions to callable capital which are currently based on program limitations rather than appropriations.

Table 19
Outstanding Long-Term LDC Public Debt (including undisbursed)
Where Debt to MDBs is Greater than Debt
to Bilateral Creditors, end-1980
(in millions of U.S. dollars)

	Multi-lateral	Bi-lateral	Finan. Markets	Suppliers	Total
Africa South of Sahara					
Benin	198	132	111	21	719
Botswana	156	79	32	2	270
Burundi	183	100	5	4	292
Central Afr. Rep.	97	74	2	39	211
Chad	119	91	4	17	231
Comoros	53	42	-	-	95
Ethiopia	551	473	15	22	1,062
Gambia	109	85	15	9	218
Ivory Coast	921	795	3,270	587	5,573
Kenya	1,408	986	562	103	3,059
Lesotho	153	12	29	-	194
Malawi	351	213	151	89	805
Niger	302	266	175	83	826
Nigeria	1,291	658	5,179	19	7,148
Rwanda	197	75	-	-	272
Swaziland	114	92	24	-	231
Tanzania	1,050	1,024	137	15	2,228
Upper Volta	272	221	14	1	508
East Asia & Pacific					
Fiji	133	110	44	6	293
Malaysia	1,466	1,158	1,987	86	4,696
Papua New Guina	273	58	292	2	625
Philippines	3,814	2,094	4,416	478	10,532
Solomon Is.	13	1	-	-	13
Thailand	2,732	2,150	2,210	185	7,277
Western Samoa	48	12	8	-	68
Latin Amercian					
Argentina	2,260	947	7,191	1,845	12,249
Barbados	108	29	17	-	155
Brazil	6,634	5,388	35,354	4,755	52,301
Colombia	2,891	1,261	2,063	483	6,703
Costa Rica	940	397	1,016	58	2,415
Ecuador	960	393	2,054	300	3,706
El Salvador	603	311	22	-	936
Guatemala	605	259	-	1	864
Haiti	261	96	8	-	365
Honduras	1,018	398	171	21	1,609
Mexico	5,237	2,155	31,247	355	38,994
Panama	640	325	1,727	36	2,727
Paraguay	556	338	228	110	1,232
Uruguay	425	222	840	38	1,524
Other					
Bangladesh	2,616	2,552	61	169	5,398
Cypress	179	73	249	20	521
Lebanon	160	111	146	-	416
Nepal	487	54	-	-	542
Yugoslavia	2,339	2,257	1,249	18	5,864

possible or equitable for the debtor country to continue to meet its scheduled obligations to the MDBs while accumulating arrears to -- or receiving debt relief from -- other countries. In this case, the MDBs would have to choose between extending new refinancing credits or rescheduling their loans. It may be desirable to initiate interagency discussion of this potential problem in order to be prepared to take the most appropriate action if such a situation arises. The situation could present itself in the case of Sudan in the near future, or Tanzania and Bangladesh somewhat farther down the road.

A related and perhaps more pressing issue involves cofinancing by private banks with the MDBs. Both commercial banks and the MDBs have expressed desires to do more cofinancing. On the commercial bank side, they are motivated in part by the possibility of obtaining the preferred status the MDBs now enjoy in debt-relief operations. So far, the MDBs have not agreed to include in their cofinancing arrangements automatic cross-default provisions, and the borrowing countries would perceive such provisions as being contrary to their interests. There are also arguments from the perspective of governments for opposing such provisions.

2. The IMF Link with Paris Club Operations

U.S. policy requires that a debtor country have in place the economic policies necessary to correct the imbalances that led to the need for debt relief. Normally, this requirement is met when the IMF Executive Board has approved an upper credit tranche arrangement with the country. This link is fairly well known and generally does not cause a problem. However, in several recent cases, there has been pressure to negotiate a debt relief arrangement before IMF approval of a standby arrangement. In the case of Nicaragua, the U.S. agreed in the summer of 1979 to participate in Paris Club negotiations with the understanding that any agreement which emerged would not go into effect until an arrangement with the IMF had been concluded. This exception was granted on foreign policy grounds in the expectation that special treatment for Nicaragua would be rewarded by a more western-oriented approach by the new government of Nicaragua. In the event, the GRN was unwilling to conclude an arrangement with the IMF and the U.S. would not agree to discuss specific rescheduling terms at the Paris Club meeting. (Subsequently, other creditors extended debt relief to Nicaragua on a bilateral basis.)

More recently, there was some discussion of negotiating a debt relief arrangement with Zaire at the beginning of 1981, before the GOZ had negotiated a new arrangement with the IMF. Even more recently, the Government of Costa Rica has raised the possibility of holding a Paris Club meeting before it concludes an arrangement with the IMF, and the French suggested Paris Club negotiations with Sudan before the IMF Board approved its new standby arrangement.

An IMF link has also been used in cases where there has been pressure on creditors to extend debt relief for more than one year. In these cases, a second or third year of debt relief has been agreed to by official creditors on the condition that the creditor country was eligible to draw under an upper credit tranche arrangement with the IMF. This kind of link is difficult to enforce, however. In 1980, for example, at the time the second year of Sudan's "one-plus-one" debt-relief arrangement was to go into effect, it was ineligible to draw from the IMF. The creditors did not take any steps to suspend the second year of relief, and any attempt to do so probably would have been counterproductive.

3. IMF/IBRD Technical Assistance

The 1980 study of LDC debt by the IMF identified weaknesses in debt management as an important contributing factor in debt crises. Given the pressures that currently exist, it would appear to be in the interest of creditor countries as a group to take steps to strengthen the debt management abilities of LDCs with weak B/P situations. This could be done effectively through the IBRD and the IMF. Both organizations have staff members competent to advise member governments in the area of debt management. In the Bank, however, there seems to be a substantial shortage of staff relative to the demand from LDC members for assistance. It is possible that the U.S. Executive Directors in these institutions could take steps to ensure that their institutions are active in all countries that need such assistance, and work more intensively in those countries that are facing serious or critical debt-servicing difficulties.

4. G-77 Pressure for Generalized Debt Relief and Institutional Reform

Serious negotiations on debt at the North/South level did not begin until 1976, at the UNCTAD IV Conference in Nairobi. These negotiations were provoked by concern over LDC debt problems associated with the "oil shock" of 1973/74. Since then, the negotiations have evolved along two tracks: (a) generalized debt relief, and (b) institutional arrangements for debt-relief operations.

a. Generalized Debt Relief

At UNCTAD IV, the G-77 called for across-the-board debt relief, preferably the cancellation of all aid loans. In March 1978, at a special Ministerial-level meeting of the UNCTAD Trade and Development board, the U.S. and other Group B countries gave way to LDC pressure in a limited fashion. They agreed to a resolution that committed them to "seek to adopt" retroactive terms adjustment (RTA) measures for the "poorer" developing countries. The conceptual underpinning of RTA was the relatively new policy of donor countries to provide aid to the "least developed" countries only in the forms of grants. Prior to this policy, many soft loans had been extended to these countries, which resulted in a flow of debt-service payments from these countries back to the donors -- an apparent inconsistency with the new policy of giving grant aid. RTA was a means of resolving the inconsistency by converting these old loans to grants.

In making this concession, the Group B countries insisted on three qualifications: (i) RTA was not debt relief -- because the benefitting countries in general did not have a debt problem -- but a means of "improving the net flow" of aid; (ii) RTA would be extended only to "poorer" LDCs, not to all of them, and (iii) each donor country would extend RTA on a case-by-case basis "within the context of its own aid policy".

The 1978 resolution did not terminate the negotiations because the G-77 now charges that the donor countries have not fully implemented the resolution. The U.S. in particular is singled out for its failure to deliver any RTA. The Carter Administration in 1979 obtained congressional authorization to extend RTA to 14 countries in FY 1980 -- amounting to $16 million. This was to be accomplished by agreements allowing each individual country to discharge its debt, one year at a time, by depositing local currency in a special account to be used to finance development activities of particular interest to the U.S. The Congress, however, did not complete the necessary appropriations action, and to date the U.S. has not extended any RTA. By contrast, all other major OECD donors have enacted RTA measures. Some of these have been quite generous. For example, some donors completely wrote off outstanding debt to all of the countries in the U.N. category of "least-developed" LDCs. Also, the U.K. extended RTA to India and Pakistan -- which are not LLDCs.

Renewed pressure from the G-77 for generalized debt relief is a distinct possibillity in the context of Global Negotiations.

b. Institutional Arrangements for Debt-Relief Operations

Apart from immediate debt relief for all LDCs, the G-77 has been pressing for institutional arrangements that would make it easier for countries in a situation of imminent default to obtain debt relief on generous terms. The G-77 argues that the present *ad hoc* creditor club approach is biased against debtor countries, and in particular fails to take into account the long-term development needs of these countries. The solution, from their point of view, is to establish a new institution (the

International Debt Commission is one version) that would replace the "Paris Club" and would arrange appropriate debt-relief operations for countries having debt servicing difficulties. To the Group B countries, this smacks of debt-relief on demand, and they have steadfastly resisted the notion.

The first round of intensive negotiations on this subject took place during the Conference on International Economic Cooperation (CIEC) in 1976-77. The U.S. and the European Community tabled a proposal at this Conference that contained the conceptual framework for a resolution on institutional arrangements that was adopted by the UNCTAD Trade and Development Board four years later. (See Appendix B). In essence, the US/EC proposal distinguished between two types of problems: (a) a debt crisis; and (b) a structural development problem in which external debt is one element. It was proposed that problems of the first (crisis) type be addressed in creditor clubs (like the Paris Club), and problems of the second (structural) type be addressed in aid consortia. For four years, there were continuous negotiations over this framework, which was referred to as "features to guide international action on LDC debt problems" (or "debt features" for short).

The "debt features" text adopted by the UNCTAD TDB in September 1980 is consistent with the views of the U.S. and other creditor countries. Unfortunately, the language of the resolution is sufficiently vague to allow the G-77 to argue that the resolution is also consistent with the eventual establishment of an International Debt Commission. As with the RTA issue, negotiations on institutional issues are likely to continue.

The most dangerous element at the moment is a vigorous effort by the UNCTAD Secretariat to insert itself in the process of resolving debt problems. The UNCTAD Secretariat has visions of playing a role as important as that of the IMF and the IBRD: sending missions to debtor countries, preparing reports, and participating in negotiations. Anything approaching such a role is unacceptable to the OECD countries because the UNCTAD Secretariat is so heavily biased toward writing off LDC debt.

An important victory on this issue was scored by the creditor countries earlier this year. The UNCTAD Secretariat had proposed that the UNDP fund an inter-regional project, managed by UNCTAD, for the purpose of providing advisors to countries preparing for rescheduling negotiations. It was apparent from the design of the project that the UNCTAD Secretariat viewed this as a vehicle for increasing its involvement in debt relief operations and for increasing pressure on the creditor countries for more generous relief. At the UNDP Governing Board meeting in June 1981, the U.S. led a campaign joined by other Group B members that succeeded in putting this project back on the shelf.

APPENDIX A

From: IMF,"Survey of Multilateral Debt Renegotiations Undertaken within the Framework of Creditor Clubs, 1975-80", SM/80/274, 30 December 1980, pp. 3-5.

Typically, debt service problems evolved over a period of several years and reflected the combined effects of prolonged and interrelated external and internal disequilibria attributable to various factors, rather than developments in a single year or the effects of a specific event. In general, therefore, debt service difficulties during the period under review could not be explained by developments immediately preceding the actual debt rescheduling exercises; on the contrary, in some instances there was a substantial improvement in the current account and even in the overall balance of payments. In these instances it was often the depleted level of reserves, the limited potential for new borrowing, or the accumulation of payments arrears which dictated an adjustment in the external accounts, most frequently through a sharp reduction in import volume.

Although the underlying economic and balance of payments situation preceding the multilateral debt renegotiations differed considerably as between countries, it is nevertheless possible to identify a number of common factors that contributed to the emergence of debt service difficulties. It is important also to note that many of the contributory developments described below (high import demand pressures, declining exports, adverse movements of the terms of trade, inflation, buildup of short-term debt, etc.) were present during the same period in many other countries without leading to the emergence of debt service difficulties: hence, it was the particular combination of external and internal circumstances and their relative severity which created debt servicing difficulties and a need for rescheduling.

The single most important factor consistently present, albeit to a varying degree, in all but one of the nine countries (India) 1/ under consideration, was the influence of domestic fiscal and monetary imbalances on the balance of payments. Aside from inflation, these domestic demand pressures were reflected primarily in rapid growth of import demand. It is generally true, however, that the sharp world price increases for oil was also a major determinant of increased import expenditures during the 1970s, although again the severity varied between countries. However, in all the cases leading up to debt rescheduling, there were substantial

1/ India's debt situation and renegotiation were exceptional in many respects as there were no prospects of imminent default. India is, therefore, the only case where creditor countries used debt relief purely as an alternative technique for providing development assistance.

increases in import volume during some of the critical years preceding the emergence of debt servicing problems; these import demand pressures nearly always could be attributed to domestic factors and particularly to expansionary budgetary and financial policies. The causes of budgetary imbalances varied among countries, but often reflected a rapid rise in expenditures related to development plans or in response to social and political pressure; in some instances government expenditures of a non-recurrent nature played a major role. Moreover, external factors such as export variability was of importance as budgetary expenditures were often adjusted rapidly upward in response to increased revenue from export taxation, but countries found it often difficult to reduce budgetary outlay to sustainable levels after the decline of world market prices from abnormally high peaks. However, in one case rapid import growth preceding debt reschedulings took place despite tight domestic demand management policies and reflected the need for large-scale food imports in light of repeated crop failures as well as highly adverse movements in import prices.

In the majority of countries debt service difficulties were exacerbated by declining, stagnating, or strongly fluctuating exports; however, in some cases debt service problems emerged despite good export performance and even in instances where countries profited from rising world prices of oil. While adverse export price movements played an important role in some countries, declining export volume was also a major problem. In several cases this can again be traced to the domestic factors of budgetary and financial imbalances, which resulted in high rates of inflation and inadequate production incentives. There was often a loss of competitiveness as the authorities found it difficult to adjust adequately the exchange rate in response to domestic inflation or worsening world market prices for exports.

Aside from developments in the trade account, debt service difficulties were compounded in some circumstances by adverse movements of the services accounts. In particular, official workers' remittances and tourist receipts fluctuated in several countries and sometimes these flows, as well as certain exports, were transacted through the more favorable parallel market, thus affecting official foreign exchange availability and debt service capability. In some countries rising social unrest affected negatively workers' remittances and tourist receipts.

While during the period under review many developing countries experienced adverse developments in their current account, it is a common feature of most of the countries in which foreign debt servicing problems emerged that they typically attempted to finance their current account deficit through external credits of which a significant, though varying share, was of relatively short maturity and carrying commercial rates of interest. Sometimes debt servicing difficulties emerged primarily as a result of inappropriate debt management; this was particularly the case where short-term debt was contracted at high rates of interest to finance long-term structural imbalances. Typically, however, many factors were involved such as stagnating or declining exports, volatile workers' remittances, rapid inflationary domestic growth propelled by the expansionary public sector, and the financing of the resource gap through unsustainable borrowing on unfavorable terms. In most instances accrued debt service payments rose sharply although actual debt service payments often declined as external payments arrears on debt servicing accumulated. There was also a significant buildup of short-term debt in the form of import payments arrears in most cases.

While a decline in official long-term assistance was a major factor in aggravating the balance of payments difficulties in a few cases, countries which had relied on substantial private foreign investments and credits were strongly affected by sharp declines and outflows of private long- and short-term capital which often reflected a loss of investors' confidence due to the underlying difficult economic and political situation. In other cases, with the buildup of large foreign debt obligations, private lenders and investors were generally eager to reduce their exposure and this was sometimes compounded by nationalization efforts, which in turn brought on additional debt servicing obligations.

Finally, in those cases where there were a series of multilateral renegotiations, the balance of payments situation often changed considerably between debt reschedulings. In some instances the balance of payments deteriorated further despite substantial debt relief; in other cases stabilization programs and increased aid, in addition to debt relief, substantially improved the balance of payments situation.

APPENDIX B

UNCTAD

544th meeting
27 September 1980

222 (XXI) Debt and development problems of developing countries

The Trade and Development Board

A

1. Welcomes the announcement by the States members of the Development Assistance Committee regarding measures taken in pursuance of section A of Trade and Development Board resolution 165 (S-IX) of 11 March 1978 and their affirmation to implement fully section A of that resolution;

2. Takes note of the nature, scope and coverage of measures announced so far by different developed donor countries in relation to the provisions and decisions of resolution 165 (S-IX) and the resultant variation in their implementation;

3. Notes that the Finance Ministers of the Group of 77, at their meeting in Belgrade on 29 September 1979, reiterated the position expressed in the Arusha Programme for Collective Self-Reliance and Framework for Negotiations that developed countries which grant relief measures to only a limited group of poorer developing countries should not be considered as having implemented fully resolution 165 (S-IX);

4. Notes also the appreciation expressed by the Group of 77 of the action taken by some developed donor countries which have interpreted and applied the retroactive adjustment of terms in a manner which met fully the expectations of developing countries in respect of implementation of section A of resolution 165 (S-IX);

5. Takes note of the statement by States members of the Development Assistance Committee that they are fully implementing section A of resolution 165 (S-IX), taking into account paragraph 5 of that resolution;

6. Urges all developed donor countries which have not done so to take the necessary steps to implement fully and immediately section A of resolution 165 (S-IX) regarding adjustment of terms on past official development assistance debt;

7. Agrees that developed donor countries should seek to continue to adopt retroactive adjustment of terms or equivalent measures in accordance with section A of resolution 165 (S-IX) so that the improvement in current terms can be applied to outstanding official development assistance debt;

8. Invites the Secretary-General of UNCTAD to keep this matter under close and continuous review and assessment and to report to the Trade and Development Board at its twenty-second session on the coverage and the degree of retroactive adjustment of terms and equivalent measures taken by developed countries in pursuance of section A of resolution 165 (S-IX);

9. Further invites all developed countries to make available to UNCTAD data necessary for this review.

B

10. Endorses the agreed detailed features contained in the annex to this resolution which elaborate the basic concepts contained in section B of resolution 165 (S-IX), and agrees that States members of UNCTAD be guided by these agreed features in future operations relating to debt problems of interested developing countries;

11. Agrees further that whenever a developing country believes it faces difficulties involving debt it may initiate consideration of a debt operation in the context of appropriate multilateral forums agreed upon by debtor and creditors. This operation will be guided by and consistent with the agreed features;

12. Decides that such a country should be able to avail itself of the expertise of appropriate international institutions which could provide, in consultation with it, an objective and comprehensive analysis of its economic situation, taking into account its social and economic objectives and development prospects. To this end, the Board invites the President of the World Bank and the Managing Director of the International Monetary Fund, in consultation with the Secretary-General of UNCTAD, to consider as soon as possible effective procedures for responding in a co-ordinated manner to requests for analysis from developing countries and requests the Secretary-General of UNCTAD to report on the consultations to the Trade and Development Board at its twenty-second session;

13. Agrees also that, only at the request of the debtor country concerned, appropriate international institutions would provide the multilateral forum with the above-mentioned and other relevant analyses in order to aid the forum in arriving at satisfactory and equitable results;

14. Welcomes in the context of Trade and Development Board resolution 132 (XV) of 15 August 1975 the invitation by the Chairman of the Paris Club to the Secretary-General of UNCTAD to participate in the meetings of that creditor group on the same basis and terms as the representatives of other international organizations participating and agrees in this context that the Secretary-General of UNCTAD would have a particular interest in the agreed features;

15. Agrees to review at its twenty-sixth session the arrangements agreed to in this section of the present resolution, and towards this end requests the Secretary-General of UNCTAD, and invites the heads of concerned multilateral institutions and forums to provide all relevant information and documentation.

Annex

Detailed features for future operations relating to the debt problems of interested developing countries

I. PREAMBLE

1. In pursuance of Trade and Development Board resolution 165 (S-IX), and taking into account the work of the Intergovernmental Group of Experts on Debt and Development Problems of Developing Countries, 1/ the following features for future operations relating to the debt problems of interested developing countries are agreed upon.

2. It was further agreed that finding a means through which debt-servicing difficulties can be avoided was one of the most important tasks facing the international community. The avoidance of debt-servicing difficulties under conditions that are consistent with an orderly development process in developing countries is in the interest of both the creditor and the debtor countries.

3. Nevertheless, it was recognized that problems can arise and it was important to have agreed arrangements for timely action.

II. OBJECTIVES

4. International action, which may vary according to the nature of the problem of the debtor country:

- should be expeditious and timely;
- should enhance the development prospects of the debtor country, bearing in mind its socio-economic priorities and the internationally agreed objectives for the development of developing countries;
- should aim at restoring the debtor country's capacity to service its debt over both the short and the long run; and should reinforce the developing country's own efforts to strengthen its underlying balance-of-payments situation;
- should protect the interests of debtors and creditors equitably in the context of international economic co-operation.

III. OPERATIONAL FRAMEWORK

Initiation

5. International consideration of the debt problem of a developing country would be initiated only at the specific request of the debtor country concerned. Accordingly, the country concerned may request such consideration at an early stage when, in its judgement, the problem involving indebtedness exists or is likely to emerge.

Analysis

6. The nature of the problem may vary from acute balance-of-payments difficulties requiring immediate action to longer-term situations relating to structural, financial and transfer-of-resources problems requiring appropriate longer-term measures.

1/ Report of the Intergovernmental Group of Experts on Debt and Development Problems of Developing Countries, Official Records of the Trade and Development Board, Tenth Special Session, Annexes, Agenda item 3, document TD/B/730.

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7. In all cases the following elements would be considered in determining appropriate international action:

(a) Examination of the domestic economic situation of the country, including an analysis of its use of both domestic and external resources for safeguarding its development process;

(b) Impact of external factors on the developmental and financial problems of the debtor country;

(c) Estimates of short- and long-term developmental capital requirements and projected availabilities;

(d) Projection of debt-servicing requirements and review of measures adopted by the country concerned to avoid debt-servicing difficulties;

(e) The structure and prospects of all items of the balance-of-payments, exchange rate and monetary policies would be given particular consideration.

8. In the case of acute balance-of-payments difficulties, the analysis would give special attention to the debtor country's short-term economic and financial policies, prospects and requirements. In the case of longer-run problems, the analysis would give special attention to the financing of long-term investment and associated resource transfers.

<u>Action</u>

9. In the light of the analysis described above, a comprehensive programme of action will be agreed upon aimed at meeting the objectives described in section II. The action programme, which will include both domestic and international measures, will vary from case to case depending on the nature of the problem at hand and the development prospects of the debtor country.

10. International measures to be implemented by bilateral and multilateral sources would vary from debt reorganization to the provision of additional financial resources on appropriate terms and conditions.

11. In the case of acute balance-of-payments difficulties in which debt servicing payments play a major role and which require immediate action, the debtor country would undertake an economic programme designed to strengthen its underlying balance-of-payments situation, having regard to its development prospects. This programme would be supported by interested parties. This support would, where necessary, include the reorganization of debts owed to or guaranteed by creditor governments.

12. In the case of longer-run problems which require appropriate longer-term measures, the debtor country concerned will undertake viable domestic policies, supported by donor countries and appropriate international institutions, which would endeavour to increase the quantity of aid in appropriate forms and improve its quality.

13. In cases where both types of problems are present, actions involving both types of measures may be required and would have to be taken in a manner which ensures that they are consistent and mutually reinforcing.

14. In the multilateral forum, agreed upon by the debtor and creditors, the Chairman would conduct the debt operation in a fair and impartial manner in accordance with the agreed objectives so as to lead to equitable results in the context of international economic co-operation.

APPENDIX C

FOR NATIONAL ADVISORY COUNCIL
USE ONLY

National Advisory Council
Action 71-506 (Corrected)
September 15, 1971

Subject : Arrearages on Debts to the U.S. Government

Action:

I. The National Advisory Council believes that the existence of significant debt arrearages to the U.S. Government or its agencies is an important consideration in passing judgment on specific loan proposals. As a general policy, the Council recommends that loans to countries whose governments are in arrears 90 days or more on debts which they or their agencies owe to the U.S. Government or its agencies should be deferred and, where appropriate, disapproved. Exceptions to this general rule must be explicitly approved.

II. In order to assure that detailed information on foreign debt arrearages is available and fully taken into consideration, the following steps are agreed:

1. In connection with Council consideration of loans or other financial transactions:

(a) Treasury will make available a listing of (i) the debts in arrears to the U.S. Government from the proposed borrower, and (ii) the length of time in arrears and the reasons for the arrearages;

(b) all other U.S. agencies which make or participate in foreign loan transactions shall make available to the Council information available to them relating to the status of loans more than 90 days in arrears to the United States Government by such borrower and make recommendations to the Council on the creditworthiness of the borrower based on such information.

2. The Council will review semiannually all arrearages on debts owed to the U.S. Government and its agencies. This review will include the amounts in arrears, changes over the period, reasons for the delinquencies and actions taken to collect each. An annual report on this subject will be submitted to the President and the Congress.

The foregoing is the text of an action of the National Advisory Council on International Monetary and Financial Policies approved on September 15, 1971.

Frederick L. Springborn

Frederick L. Springborn
Acting Secretary

References:
NAC Document 71-453
Staff Committee Minutes 71-44

FOR NAC USE ONLY

Action 76-347
May 18, 1976

National Advisory Council
On International Monetary and Financial Policies

Subject: Standard U.S. Government Procedure for Collecting Foreign Debt Arrearages

Action:

The National Advisory Council approves the following Standard Procedure for collecting arrearages on foreign indebtedness to the United States Government and its agencies:

(a) Primary responsibility for collecting all foreign debt arrearages rests with the U.S. creditor agency. The creditor agency shall pursue actively all feasible means of collecting arrearages including, if it is necessary, recourse to the Department of State or other agencies of the United States Government.

(b) If, after the expiration of 90 days, the creditor agency has not been able to collect a "major" foreign debt arrearage, that creditor agency shall submit a written report on the status of the major foreign debt arrearage to the NAC Working Group on Foreign Debt Arrearages. The report will provide details of the debt arrearage, including a description of the original credit and the nature of the arrearage, the amounts involved, the date of oldest arrearage, whether deliveries have been made, credit and other identification numbers and related information. The report should also detail the creditor agency's efforts to collect the debt arrearage, the country's responses and the creditor agency's views as to other viable alternative courses of action which might be pursued by the U.S. Government to ensure prompt settlement of the arrearage. If the creditor agency does not feel that the assistance or further assistance of the Department of State is required at the end of this 90-day period for technical reasons arising from problems in billing, missent payments or other administrative problems, the report should contain such a justification.

(c) Upon receipt of the report on the status of the major foreign debt arrearage, the NAC Working Group on Foreign Debt Arrearages will determine whether or not to recommend that assistance in collecting the arrearage be provided by the Department of State through diplomatic channels, or by other agencies of the United States Government.

(d) If the arrearage remains uncollected after the expiration of an additional 30 days the NAC Working Group on Foreign Debt Arrearages shall report any recommendations for further specific corrective measures to the NAC no later than 130 days after the initial due date of the payments in arrears.

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(e) The NAC, in reviewing these long-standing arrearage cases, shall take into account the policy on debt arrearages set forth in NAC Action 71-506 and such other considerations as it may deem appropriate in approving further steps for arrearage collection efforts.

The Standard Procedure for collecting foreign debt arrearages is complementary to, and does not substitute for, Treasury Fiscal Requirement Manual, Part II, Chapter 4500, Transmittal Letter No. 171 of January 27, 1976. All agencies of the U.S. Government shall ensure that internal agency regulations and procedures for reporting and collecting arrearages on foreign indebtedness are made consistent with Treasury reporting requirements and the Standard Procedure developed in the NAC framework.

For purposes of initiating this Standard Procedure, a "major" foreign debt arrearage is defined as any country-program arrearage which involves the sum of $250,000 or more. A principal objective of the procedure, however, in the longer run, is to reduce this "major" criterion from the initial $250,000 figure to $100,000.

The foregoing is the text of an action of the National Advisory Council on International Monetary and Financial Policies approved on May 18, 1976.

Robert S. Watson

Robert S. Watson
Secretary

References:
NAC Document 76-303
Staff Committee Minutes 76-21

FOR NAC USE ONLY

Action 76-415
May 18, 1976

National Advisory Council
On International Monetary and Financial Policies

Subject: Working Group on Foreign Debt Arrearages

Action:

The National Advisory Council approves the establishment of a permanent Working Group on Foreign Debt Arrearages, chaired by the Treasury Department, charged with the following responsibilities:

(1) Operation of a U.S. Government-wide Standard Procedure for the collection of major arrearages on foreign indebtedness owed to the United States Government and its agencies. This Standard Procedure is approved in NAC Action 76-347.

(2) Submission of reports to each meeting of the NAC Staff Committee on the current status of significant debt arrearages which the Working Group has determined constitute serious collection problems with countries involved in Staff Committee consideration of proposed loans and credits of the international financial institutions and the lending agencies of the U.S. Government;

(3) Recommending to the NAC, as appropriate, specific courses of action to resolve foreign debt arrearage problems including recommendations as to actions to be taken in the context of the approved debt policy prescriptions set forth in NAC Action 71-506.

(4) Such other responsibilities relating to arrearages on foreign indebtedness to the U.S. Government and its agencies as may be assigned to it by the National Advisory Council.

The foregoing is the text of an action of the National Advisory Council on International Monetary and Financial Policies approved on May 18, 1976.

Robert S. Watson
Secretary

References:
NAC Document 76-303
Staff Committee Minutes 76-21

APPENDIX D

FOR NAC USE ONLY

Action 76-5
January 6, 1978

National Advisory Council
On International Monetary and Financial Policies

Subject: Proposed Policy Statement on Debt Reorganization

Action:

The National Advisory Council advises the Secretary of the Treasury that it approves the following proposed policy statement on multilateral debt reorganizations:

1. Debt-service payments on international debt should be reorganized on a case-by-case basis only in extraordinary circumstances where reorganization is necessary to ensure repayment. Debt relief should not be given as a form of development assistance.

2. Debt-service payments on loans extended or guaranteed by the U.S. Government will normally only be reorganized in the framework of a multilateral creditor-club agreement.

3. When a reorganization takes place that involves government credits or government-guaranteed credits, the U.S. will participate only if:

   (a) the reorganization agreement incorporates the principle of non-discrimination among creditor countries, including those that are not party to the agreement;

   (b) the debtor country agrees to make all reasonable efforts to reorganize unguaranteed private credits falling due in the period of the reorganization on terms comparable to those covering government or government-guaranteed credits;

   (c) the debtor country agrees to implement an economic program designed to respond to the underlying conditions and to overcome the deficiencies which led to the need for reorganizing debt-service payments.

4. The amounts of principal and interest to be reorganized should be agreed upon only after a thorough analysis of the economic situation and the balance-of-payments prospects of the debtor country.

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5. The payments that are reorganized normally should be limited to payments in arrears and payments falling due not more than one year following the reorganizing negotiations.

The foregoing is the text of an action of the National Advisory Council on International Monetary and Financial Policies approved on January 6, 1978.

Robert S. Watson

Robert S. Watson
Secretary

References:
NAC Document 78-1